



Market Segment Specialization Program



Bail Bond Industry

The taxpayer names and addresses shown in this publication are hypothetical. They were chosen at random from a list of names of American colleges and universities as shown in Webster's Dictionary or from a list of names of counties in the United States as listed in the United States Government Printing Office Style Manual.

This material was designed specifically for training purposes only. Under no circumstances should the contents be used or cited as authority for setting or sustaining a technical position.



Department of the Treasury
Internal Revenue Service

Training 3147-116 (7/97)
TPDS No. 83045L

This page intentionally left blank.

BAIL BOND INDUSTRY

TABLE OF CONTENTS

	<u>Page</u>
Chapter 1, Introduction	
Areas of Noncompliance	1-1
Third Party Records	1-1
Chapter 2, An Overview of the Bail Business	
State Control	2-1
Bail Bond Defined	2-1
Types of Licenses	2-1
Transacting Bail	2-2
Surety Contracts	2-2
Subagents	2-3
Chapter 3, Project Initiation	
Identifying the Target Population	3-1
Screening and Selection Process	3-2
Chapter 4, Nature of Business	
General Attributes	4-1
Books and Records	4-1
Terminology	4-3
Chapter 5, Applicable State Laws	5-1
Chapter 6, Preliminary Audit Steps	
Introduction	6-1
Internal Sources of Information	6-1
Third Party Sources	6-2
Initial Interview	6-2
Required Filing Checks	6-3

Chapter 7, Primary Audit Issues

Gross Income	7-1
Income From BUF Accounts	7-1
Premium Income	7-2
Reimbursed Expenses	7-3
Collateral	7-3
BUF Payment Deductions	7-4
Tax Treatment of Bond Costs	7-5
Change in Accounting Method	7-6

Chapter 8, Establishing Fraud

Understatement of Tax	8-1
Fraudulent Intent	8-2

Chapter 9, Future Considerations 9-1

Chapter 1

INTRODUCTION

AREAS OF NONCOMPLIANCE

Noncompliance in the bail bond industry was initially identified in a project conducted by one of our districts through the Examination function. There appeared to be a relatively high incidence of nonfilers, and of those returns audited, there was often a lack of adequate books and records to support income and expenses claimed.

The first indication that there was noncompliance in filing returns was observed by checking the filing records of persons advertising in the phone books. Of the names checked, almost a third were nonfilers.

Two primary issues were identified during a preliminary study consisting of the examination of the returns of 12 bail bond agents. Unreported income and the deduction of payments into the agents' reserve accounts (commonly called Build Up Funds or BUF accounts) were the two prevalent issues. Also, personal expenses were frequently being deducted as business expenses.

THIRD PARTY RECORDS

The use of third party records in this project was important due to the areas of noncompliance initially observed. Based upon the manner in which this industry operates in the state in which this study was conducted, two primary third party sources of information were utilized: the state department of insurance and the insurance companies for whom bail bond agents write bail.

Most states have a department of insurance, and most of the insurance companies affiliated with bail agents operate in many states. However, since the bail industry may operate differently in different states, it is important to determine how it functions in each state before a project or examination is conducted within that state.

Typically, a state's department of insurance regulates the licensing and operations of bail agents within that state. Hence, this agency can be important in initially identifying the population of bail agents within an IRS district and in providing additional information about specific bail bond agents. Also, the state regulations can provide information such as licensing and record keeping requirements.

Insurance companies affiliated with bail agents can provide information regarding bail bond income, expenses, and BUF accounts. This information was used in the initial screening process for audit potential. It also provided an additional source of income and expense records when the agents' own records were inaccurate. An indirect method of determining income was based upon the insurance company records.

Chapter 2

AN OVERVIEW OF THE BAIL BUSINESS

STATE CONTROL

In general, any individual who transacts bail for a fee in a given state must be licensed by the state's department of insurance. Various laws and regulations set forth requirements for licensing, record keeping, the collection of fees from and by the licensed bail agents, and maintenance of a BUF account with a surety company.

BAIL BOND DEFINED

A bail transaction includes any contract for the release of a person arrested or confined on account of an actual or alleged violation of any state or federal law. This could include a release by means of cash or other property that is acceptable to the court in lieu of bail.

This audit guide is concerned specifically with bail agents transacting bail on behalf of an insurance company. Licensed bail agents represent surety companies, which issue bail bonds. This type of bail bond is a contract wherein the surety company, which is ultimately liable on the full amount of the bond, contracts with a bail agent, who promises to indemnify the surety company for forfeitures and related costs on bonds written by him or her if the defendant fails to make any scheduled court-ordered appearances. The bail agent has a prescribed period to surrender the defendant after the Notice of Forfeiture before a Summary Judgment is issued and payment is due.

TYPES OF LICENSES

In the state in which the study was conducted, the department of insurance issues three kinds of bail licenses:

1. Bail Permittee

This license permits the licensee to solicit, negotiate, issue, and deliver bail bonds by posting his or her own funds with the court, as opposed to posting a bond through a surety company.

2. Bail Agent

This license permits the licensee to act as the agent of a surety company, the contracts (bonds) of which are posted with the court, rather than actual cash or other property. This is the most common kind of license. Most bail permittees are also licensed as bail agents.

3. Bail Solicitor

This license permits the licensee to transact bail on behalf of, and as an employee of, either a bail agent or a bail permittee.

TRANSACTING BAIL

After an arrest, the most common means of securing the release of the defendant is by means of posting a bond through a bail agent. The defendant, or one or more co-signors, signs a bail agreement with the bail agent which provides for reimbursement of expenses to the bail agent if the defendant fails to appear in court. These expenses include the full amount of the bond forfeited, reasonable expenses incurred by the bail agent to locate and surrender the defendant, and related court costs incurred.

Under this agreement, the bail agent collects a bail bond premium which he or she earns upon the release of the defendant. The premium amount is generally 10 percent of the face amount of the bond. From this premium collected, the bail agent makes two payments to the surety company, one for bond costs, and the other for his or her BUF account.

In addition to the bail bond premium, the bail agent may also collect collateral from the defendant, based upon his or her assessment of risks involved in the transaction. The collateral may be in the form of cash or other property, such as jewelry, cars, or deeds of trust.

SURETY CONTRACTS

When a bail agent contracts with a surety company, he or she is contracting to write bail bonds for the surety company as its agent. The surety company is ultimately liable for all bonds written by the bail agent on its behalf. The contract specifies premium rates, bond costs, and BUF payments, and contains an indemnity agreement. Other areas that are usually addressed include treatment of collateral, weekly reporting requirements, and terms for the return of the BUF account balance. The contract may

also limit the amount of bail that the bail agent is permitted to write per bond.

The indemnity agreement specifies that the bail agent is responsible for any expenses relating to bonds written by the bail agent. These include the apprehension, movement, or surrender of the defendant, as well as any expenses relating to bond forfeitures.

The contract sets forth the terms regarding the blank bonds supplied by the surety company and the related bond costs. Blank bonds of various denominations are sent to the bail agent usually as replacements for previously executed bonds. Bond costs are expressed as a percentage of the face amount of the bond. Rates typically range from 1.2 percent to 1.5 percent of the face amount of the bond. Surety companies generally require strict accountability for each blank bond issued.

The surety contract also requires the bail agent to make payments into a reserve account, commonly called a Build Up Fund, or BUF account. This fund is held in trust for the agent by the surety company in a separate account in a financial institution. The purpose of this BUF account is to provide funds to cover any potential liabilities incurred as a result of any forfeitures of bonds written by that specific agent. The bail agent usually has no access to these funds, and the surety company can make withdrawals from the account without permission from the agent. The BUF payment is based on a certain percentage, usually 1 percent, of the face amount of the bond as stipulated in the surety contract.

The surety contract specifies that, once it is terminated by either party and all outstanding obligations have been satisfied, the remaining funds along with accrued interest will be returned to the bail agent. It may be several years after termination of the contract before all outstanding liabilities are satisfied.

The bail agent is usually required by contract to file a weekly report of bail transactions with the surety company. This report lists specific information on each bond written, the total premiums earned, and the related total liability (face amounts) of the bonds written for that period. The computed bond costs, BUF payment, and exonerated bonds are also listed.

SUBAGENTS

A bail agent learns the bail business by on-the-job training, working for another bail agent. If the employee develops a good relationship with his or her employer and has a good grasp of the business, he or she may graduate to being a subagent of his or her former employer.

Under this relationship, the subagent becomes a sole proprietor, buying his or her bonds from his or her former employer, now his or her general agent. This creates an additional layer of liability on the bonds written by the subagent in that the general agent is also liable for all bonds written by his or her subagent. For this reason, the subagent will often pay into two BUF accounts, one through the surety company and one through his or her general agent. The subagent will also pay bond costs to his or her general agent in addition to the bond costs paid to his or her surety company. These additional bond costs are usually .3 percent to .5 percent of the bonds written by the subagent.

The reporting requirements will be the same, with the weekly reports generally going to the general agent before, or in addition to, the reports to the surety company. In this case, four checks will usually be submitted with the subagent's report, two for the BUF accounts and two for the bond costs.

Chapter 3

PROJECT INITIATION

IDENTIFYING THE TARGET POPULATION

In many states, bail agents who write bail, whether acting in their own behalf or for another agent, must be licensed. Thus, the first step in identifying your target population is to obtain from the state licensing agency (typically the department of insurance) a list of all bail agents in your state. Using the mailing addresses from this list, you can identify the bail agents located in your district.

You should not use Principal Business Codes and Professional Activity Codes ("PIA Codes") to identify the initial population for two reasons. First, there is no specific PIA Code for the bail bond industry. Second, the use of PIA Codes would limit the population to taxpayers who filed returns, which might exclude a significant portion of the target population.

After identifying the bail agents in your area, you can submit your list to the state licensing agency with a request for further information concerning each bail agent. The agency might be able to provide information such as the kind of license issued, the names of the surety companies with which the agent is affiliated, the agent's business and residential addresses, any business name used by the agent, any related partners, and a list of the agent's employees. The licensing agency might also be able to provide the dates of various actions concerning the agent's license.

After obtaining this information, you can then contact the surety companies most commonly used by bail agents in your district and request information relating to specific agents. If a surety company requires a summons before it will provide information, you should issue a summons for each bail agent about whom you are requesting information.

The surety companies can provide data on specific bail agents regarding total bail premiums earned, bond costs incurred, BUF payments which the bail agents made to the surety companies, and total interest accrued on the agents' BUF accounts. The companies can also provide data regarding specific withdrawals from the agents' BUF accounts.

Exhibit 3-1 is a summons used during the initial screening process of a project to obtain summarized information from surety companies when it is necessary to evaluate the audit potential of a large initial population of bail agents. If, during the examination of a bail agent, more specific information is needed from a surety company, another summons must be issued for specific records.

As stated above, bail agents are required by many states to be licensed. Therefore, your initial population of bail agents in your district might include not only sole proprietors and partnerships, but also bail agents who work for other agents on commission or as employees. From the information received from third parties, you can segregate those agents in the latter group from the sole proprietors and partnerships, who comprise your target group.

SCREENING AND SELECTION PROCESS

Although a few operate as partnerships, bail bond agents operate primarily as sole proprietors. In many states, only a natural person may hold a bail bond license. Thus, in those jurisdictions, there should be no bail bond businesses filing corporate returns.

To complete the collection of data to enable you to evaluate the audit potential of each bail agent, consult and summarize internally generated information such as RTVUES, transcripts, IRP documents, and Currency and Banking Research data, together with the third party information discussed above.

The bail income and expense data obtained from the surety companies and the Schedule C data from RTVUES are useful in determining which returns to order. Because the deduction of BUF payments is a primary audit issue (as discussed below), the BUF account balance should be a primary factor in the selection process.

Because bond costs generally are 12 to 15 percent of premiums earned, a bail agent's cost of goods sold or separately stated bond costs per return should reflect a similar percentage unless other expenses such as court costs are included in that amount. Any expenses exceeding the 12 to 15 percent amount might indicate that the bail agent is expensing payments into BUF accounts.

Other factors can be considered in determining the audit potential of a bail agent. Any significant differences between gross receipts shown on the bail agent's return and data obtained from the surety companies or any separately stated expenses for BUF payments should be taken into account, regardless of the bail agent's net profit percentage.

This is a sample of Form 2039(c), Summons, (Rev. 7-92). This form should be available locally.

Form 2039 (c)
(Rev. July 1992)

Summons



Department of the Treasury
Internal Revenue Service

In the matter of Bail Agent's Name

Internal Revenue District of _____ Periods _____

The Commissioner of Internal Revenue

To Surety Company Name

At Surety Company Address

You are hereby summoned and required to appear before Revenue Agent's Name, an officer of the Internal Revenue Service, to give testimony and to bring with you and to produce for examination the following books, records, papers, and other data relating to the tax liability or the collection of the tax liability or for the purpose of inquiring into any offense connected with the administration or enforcement of the internal revenue laws concerning the person identified above for the periods shown.

Total dollar amount of bonds written in _____ and _____.

Total premiums for bonds written in _____ and _____.

Total bond costs paid in _____ and _____.

Total payments to all Build Up Fund accounts in _____ and _____.

Total withdrawals from all Build Up Fund accounts in _____ and _____.

Please indicate if any withdrawals were for Summary Judgments.

Total beginning balance of all Build Up Fund accounts at January 1, _____.

Total accrued interest for all Build Up Fund accounts in _____ and _____.

Do not write in this space

Business address and telephone number of Internal Revenue Service officer named above:

Place and time for appearance:

at _____

on the _____ day of _____, 19 _____ at _____ o'clock _____ m.

Issued under authority of the Internal Revenue Code this _____ day of _____, 19 _____

Signature of Issuing Officer

Title

Signature of Approving Officer (if applicable)

Title

Original to be kept by IRS

Form 2039(c) (Rev. 7-92) 21407F

This page intentionally left blank.

Chapter 4

NATURE OF BUSINESS

GENERAL ATTRIBUTES

Bail bond businesses are generally operated on the cash basis method of accounting. Income is recognized when received, and expenses are claimed when paid.

In addition, this industry tends to be cash intensive, in that bail agents often prefer to collect cash rather than checks, due to the nature of their clients. Gross receipts are usually 50 percent to 80 percent cash.

Bail bond businesses reflect business practices typical of other small businesses in terms of the lack of internal control. The work force generally consists of the bail agent and perhaps one or two employees. This means that office functions such as writing bail, collecting fees, and depositing receipts may all be done by the same person.

The surety company provides a measure of control in terms of tracking premiums earned due to its weekly reporting requirement and the fact that it tracks the bonds by serial number. Bail agents are required to account for every bond in their possession. However, the surety company does not control the actual collection of the premiums that the bail agents earn on each bond they write. The surety company also is not involved in any other cash collections such as cash collateral and additional fees collected for travel, court costs, and long distance phone calls.

BOOKS AND RECORDS

Certain books and records are specific to the bail industry. As the state laws indicate, the bail bondsman is required to provide copies of documents relating to a bail transaction to the defendant and must retain all pertinent documents at his or her place of business for 5 years beyond the completion of all parts of a bail transaction.

The following items reflect those books and records that are specific to the bail bond business:

1. Numbered weekly reports to the surety company(ies) with which the bail agent is affiliated. (Although most surety contracts require weekly reporting, these reports are often less frequently provided.) The information contained in these reports includes specifics on each bond written, including the serial number of the bond, the date the bond was written, the name of the defendant, the premium and the

face amount of the bond. The totals reflected on the report include total liability (of all bonds), the total premiums earned, the total bond costs, and the BUF payment made.

2. Canceled checks for bond costs and BUF payment. These are submitted along with the weekly report and may be separate checks or a single check, depending on the surety company involved. The checks should indicate the related report number. If the agent is a subagent working through another agent, there should be one or two more checks -- one for bond costs to his or her general agent, and, if a local BUF account is required by the general agent, another check for the local BUF account.
3. Bank statements/accounts. There should be at least three business-related bank accounts: the BUF account maintained by each surety company with whom the agent is affiliated, the collateral account for all cash collateral received, and the operating account. There may also be a local BUF account as mentioned above.
4. Income receipts. The bail agent is required to provide a receipt for the premium received. This can be either from a separate receipt book or as part of the bond the surety company provides to the bail agent.
5. Collateral receipts. The agent might or might not have written a separate receipt for collateral as required by state regulations.
6. Invoices for blank bonds from the surety company. All blank bonds sent from the surety company to the bail agent must be accounted for by the bail agent. The blank bonds, which are usually sent as replacements for bonds previously written, come in various denominations. For instance, a \$15,000 bond can be used to write a bond for any amount up to \$15,000. The serial numbers and denominations for all bonds sent to the agent should be indicated on the invoice.
7. Bail agreement. This bail contract is between the defendant or a co-signor and the bail agent. State law will prescribe the items to be included in this contract. The most important items to the revenue agent are the premium received and the form and amount of collateral that may be collected.
8. Surety contract. This will give the contractual amounts of the premiums, requirements for the BUF account, and bond costs charged by the surety company. It will also name the general agent if the contract is for a subagent. The premium, BUF payment, and bond costs are usually expressed in percentages. The following figures are typical of surety contract terms:

Premium earned	10% of face amount of bond
BUF payment	1% of face amount of bond
Bond costs	1.2% - 1.5% of face amount of bond

TERMINOLOGY

Due to the fact that bail transactions are an integral part of our court system, the terminology used in this industry includes legal terms as well as other terms specific to this industry. The following terms are commonly used in this industry:

1. BUF Account. This **Build Up Fund** is the reserve account that is maintained by the surety company for the bail agent in order to cover any potential liability to the surety company for the bonds written by the agent. If the bail agent is a subagent for another agent, he or she may also pay into a local BUF account maintained by the other agent, his or her general agent.
2. Exoneration. "A bail bond is exonerated by appearance of the defendant to answer judgment of the court in conformity with terms of the bond." **Cain v. United States**, 148 F.2d 182 (9th Cir. 1945). Once a bond is exonerated, the bail agent and the surety company are relieved of any liability under the bond.
3. Forfeiture. The forfeiture of a bond is "a failure to perform the condition upon which the obligor was to be excused from the penalty in the bond." **Black's Law Dictionary** 778 (4th Ed. 1968). A forfeiture generally occurs when a defendant fails to make all court appearances as required by the terms of his or her bond.
4. Penal amount. This term is interchangeable with the full amount, the face amount, or the total liability of the bond.
5. Premium. This is the fee earned by the bail agent for writing a bond. It is usually equal to 10 percent of the face amount of the bond. This fee is earned once the defendant is released from jail.
6. Posting fee. When a bail bond is written for a defendant who is located in another county, the bail agent will pay a fee to a bail agent in the other county to post a bond for him or her.
7. Skip tracer. Otherwise known as a bounty hunter, this person is paid a fee by the bail agent to track down and retrieve a defendant who has skipped. This is done to avoid having to pay a Summary Judgment, should the defendant not be located. Fees charged can be as much as 50 percent of the amount of the bond.
8. Summary Judgment. The court enters Summary Judgment against a bail agent upon the nonappearance of the defendant. For example, per section 1306 of the California Penal Code, the Summary Judgment is entered after the 180-day period has lapsed following the bond forfeiture. The bail agent is then liable for the full amount of the bond per his or her surety contract.

This page intentionally left blank.

Chapter 5

APPLICABLE STATE LAWS

In order to understand the income and expenses generated in the bail bond business, it is advisable to have at least a limited understanding of the laws that bail agents must adhere to concerning fiduciary responsibilities involving the arrestee, record keeping requirements, and court procedures. The laws regulating this industry vary from state to state. Therefore, an examiner should be familiar with the laws of the state of the bail agent under examination.

There are often three separate sources of state laws which affect the operations of bail bond businesses. A state's insurance code might provide the qualifications and licensing requirements for bail licensees and a state's administrative code might provide definitions and regulations relating to bail operations. Because transacting bail is an integral part of the operations of a criminal court system, various aspects of the bail bond business can be defined in a state's penal code.

This page intentionally left blank.

Chapter 6

PRELIMINARY AUDIT STEPS

INTRODUCTION

Due to the fact that bail bond businesses often have poor business records and because of the degree of noncompliance in this industry, it is important to make use of all internal resources and third party sources of information, whenever possible, in order to have an effective audit. Interviewing the taxpayer will help determine to what extent third party resources will be needed in that the degree of internal control and the degree of the taxpayer's involvement in daily activities can be determined in the initial interview. See Exhibit 6-1 for a sample of an Information Document Request.

INTERNAL SOURCES OF INFORMATION

The Currency and Banking Retrieval System (CBRS) is used to track cash transactions over \$10,000. Since the bail bond business is cash intensive, the information from this system is particularly useful. The two forms that are most often encountered in this industry are the Form 4789, Currency Transaction Report, and the Form 8300, Report of Cash Payments Over \$10,000 Received in a Trade or Business. As discussed below, these forms serve slightly different purposes. The presence of one of these forms does not necessarily lead to a requirement that the other form be filed.

Form 4789 is filed by financial institutions when cash is withdrawn or deposited in amounts greater than \$10,000. This form identifies the depositor, the business for whom the deposit is made, the amount deposited, and into what bank account the funds are deposited. The amounts can be summarized and compared with the gross receipts per return and the business records presented during the audit. During the examination, these transactions can be compared with specific cash receipts per books to possibly identify income that is not deposited.

Form 8300 is filed by the bail agent when he or she receives cash in excess of \$10,000 in the course of his or her trade or business. For a definition of "cash" for purposes of Forms 8300, see Treas. Reg. section 1.6050I-1(a). Information on CBRS that a bail agent filed Forms 8300 is evidence that the bail agent has complied with IRC section 6050I. However, the examining agent should investigate the circumstances of cash deposits resulting in Form 4789 for the presence of exceptionally large bonds. It is customary in the industry for the bond premium to be 10 percent of the face amount of the bond. A bond with a face value of more than \$100,000 probably would generate a bond premium of more than \$10,000 for the bail agent. Thus, the bail agent might

have been required to file a Form 8300 for that bond.

According to observations made so far in this industry, there are relatively few bonds written for more than \$100,000, the amount that indicates a potential requirement for filing a Form 8300. A bail agent's surety contract will often limit the bail agent from writing bail in excess of \$25,000 or \$50,000 without specific approval of the surety company. Most bonds are for \$3,000 to \$20,000, earning the bail agent 10 percent of the bond amount. Hence, there may be a number of Forms 4789 generated due to these smaller bonds with a relatively few Forms 8300 required to be filed.

IRP transcripts can also be used to identify sources of income such as interest, dividends, rental income, and sales of stocks, bonds, and real estate. They can also be useful in identifying bank accounts and other investments.

THIRD PARTY SOURCES

Information from a state's department of insurance can be useful in providing a general profile of the business before the examination has begun. Information such as the date the bail license was issued, the type of license, the number of employees in the business, and whether or not there are any partnerships involved can usually be provided. The department might also provide a list of surety companies that the agent has worked with and the dates involved.

If surety company information is obtained in the initial screening process for cases with audit potential, this information can be used during the pre-audit to compare income and expenses per surety company information with income and expenses per Schedule C filed by the taxpayer.

Surety companies can also be a source of additional information regarding income and expenses during the audit if the business records are inadequate. Timing differences between the surety company information and the business records should be resolved. Weekly bail agent reports, if available, are useful for this purpose.

Some surety companies require a summons before they will provide information. Exhibit 3-1 is a sample of a summons that can be used to obtain summarized information for initial screening purposes. A more detailed summons should be used for an individual audit.

INITIAL INTERVIEW

The initial interview is a crucial step in the audit process. This may be your only opportunity to talk to the taxpayer. It is important to establish how involved the taxpayer is in daily operations, what books and records are generated, and what internal control measures are used, particularly in handling cash. The authority to

interview the taxpayer is found in IRC section 7602. Any decision to summons the taxpayer should be discussed with management.

Since this industry is cash intensive, questioning concerning cash should be thorough. Questions such as who handles cash transactions, who deposits the cash, and how often deposits are made should have follow-up questions to provide as much detail as possible.

Since unreported income is a common issue in this industry, and because bail agents often use bank deposits to determine gross receipts per return, it is important to determine from the bail agent if all cash receipts are deposited, if he or she pays any expenses with cash, and what bank accounts are used.

Since one indirect method of determining income is based upon calculating premiums earned, it is crucial to establish in the initial interview as much detail as possible about uncollected accounts. This could include an estimate of the average percentage of uncollected premiums per year and whether any year under examination varied from the norm. It should also be determined how the agent tracks outstanding accounts, what records are kept, and what collection measures are used, such as a collection agency.

Questioning should also include how collateral is handled and what form of collateral is taken, such as cash, personal property, or deeds of trust. It should be determined where cash collateral is deposited, whether any is deposited in the operating account before being transferred to the collateral account, and how it is handled on the books. Collateral receipts should be inspected, if available, to determine the disposition of the collateral. The taxpayer should be asked if any collateral was seized or retained by the bail agent to cover outstanding bills or forfeitures.

Questioning regarding other sources of income or deposits such as loan proceeds and sale of assets should be thorough. If the taxpayer is using bank deposits to reflect gross receipts per return, the taxpayer should be asked what specific items are being deposited into his or her operating account or any other accounts used for his or her business. The taxpayer should also be questioned regarding what accounts are used for his or her personal expenses.

REQUIRED FILING CHECKS

Procedures covering Required Filing Checks (formerly known as Package Audit Requirements) are found in IRM 4034. The requirements call for the examiner to ascertain that all required returns are being filed, that Forms W-4 are being filed accurately, that information returns are being filed when appropriate, and that withholding returns be inspected for timeliness and accuracy. The areas that may require further investigation are employment taxes and information returns.

In terms of employment tax issues, the bail bond industry is no different from any other type of business in regard to employees and independent contractor issues. In determining whether a provider of services should be considered an employee or an independent contractor, the 20 common-law factors in Revenue Ruling 87-41, 1987-1 C.B. 296, should be used.

The initial interview should include questions regarding Form 8300 filing requirements. It should be determined if the taxpayer was aware of the filing requirements, and if so, when was he or she aware. If any Forms 8300 were filed during the years under examination, copies should be inspected. Income receipts should be inspected to determine if there were any cash transactions that would require the filing of a Form 8300.

Form 4564 Rev. 6/88	Department of the Treasury Internal Revenue Service INFORMATION DOCUMENT REQUEST	Request Number
TO: Name of Taxpayer and Co. Div. or Branch		Subject
Please return Part 2 with listed documents to requester identified below.		SAIN No. Submitted to: Dates of Previous Requests

Description of Documents Requested

- (1) All work papers used in preparing the tax return, both those generated by your accountant and those generated internally, that is, working trial balance, adjusting journal entries, etc.
- (2) All bank statements, including passbooks, canceled checks, deposit slips, and reconciliations for all months, including 1 month prior to and 1 month after the tax year being examined. Please include copies of all statements for accounts held in trust for you by your surety company or another agent.
- (3) Purchase invoices/closing statements or other pertinent records for the acquisition, sale or other disposition of investments, capital assets, depreciable assets, real estate, or other property.
- (4) Bail bond business:
 - a) All ledgers and journals relating to income and expenses.
 - b) Copies of receipts for premiums collected, collateral taken, and reimbursed expenses, etc.
 - c) Records and source documents regarding any collateral seized by you for outstanding premiums, charges, or Summary Judgments.
 - d) Weekly statements to and from surety companies and/or general agent. (Any accounting for bond premiums, bond costs, and reserve deposits and withdrawals).
 - e) Client cards or other records regarding payments received for outstanding liabilities.
 - f) Source documents relating to any Summary Judgments paid.
 - g) Contract(s) between you and your surety companies.
 - h) Forms 1099 issued and received.
 - i) Forms 8300 issued.
- (5) All payroll tax returns that were due during the year under examination. (Federal Forms 941, 940 and State Forms DE-3.)
- (6) Copies of Forms 1040 for the 2 years prior to the year(s) under examination and any subsequent year returns, for inspection only at this time.

Information Due By _____ At Next Appointment [] Mail In []		
FROM:	Name and Title of Requester	Date
	Office Location	

This page intentionally left blank.

Chapter 7

PRIMARY AUDIT ISSUES

GROSS INCOME

A thorough income probe is a crucial step in the audit process since unreported income is often an issue in this industry. The first step of the probe should be the initial interview with the taxpayer, with effective questioning directed at all possible sources of income, from the bail bond business and from unrelated sources. Exhibit 7-1 is a sample questionnaire that can be used as a reference. Questions should be tailored to address the specific facts and circumstances of each case.

Since books and records are often inadequate in this industry, indirect methods should be utilized to determine the reasonableness of income reported. Although many taxpayers in this industry use bank deposits to reflect gross receipts per return, a bank deposit analysis should not be used as the primary indirect method since often up to 80 percent of income received is in the form of cash. This fact, together with the lack of internal controls that are often characteristic of this size and type of industry, may suggest that not all receipts are being deposited.

Bank statements should, however, be inspected since other sources of income can be discovered. Also, during the initial interview with the taxpayer, it should be determined how personal expenses are paid and what bank accounts are used, if any, for personal expenses.

INCOME FROM BUF ACCOUNTS

A bail agent generally does not have access to funds deposited in his or her BUF accounts. However, the amount of restrictions placed on these BUF accounts may vary from case to case. Although most large surety companies place substantial restrictions on the BUF accounts, not all of them do. Also, general agents often set up local BUF accounts for their subagents with varying restrictions placed on them.

Therefore, each case should be evaluated to determine if substantial restrictions or limitations exist with respect to the BUF accounts involved. If it is determined that there are substantial restrictions or limitations on an account, then the bail agent does not constructively receive interest income from this account in the year in which it is credited to his or her account, see Treas. Reg. section 1.451-2(a).

However, an examiner should determine whether the proceeds of any of the restricted BUF accounts of a bail agent under examination were distributed by the surety company, either upon termination of the contract or in satisfaction of the bail agent's obligations to the surety company. In such an event, the bail agent might have received BUF account interest income in the year of distribution.

PREMIUM INCOME

The primary source of income in the bail bond business is premium income received from writing bonds. An indirect method of determining premiums earned is used to test the reasonableness of gross receipts per return, and, when adequate books and records are lacking, this indirect method serves as a starting point for determining gross receipts per examination. When adequate books and records are available, discrepancies between the taxpayer's books and surety company records should be reconciled.

Since most surety contracts require a BUF payment of 1 percent of the bonds written and premiums earned equal to 10 percent of the bonds written, premiums earned for the year can be calculated based upon the total of the BUF payments made for the year. For instance, if the total BUF payments are \$50,000, the premiums earned on the bonds would equal \$500,000. To arrive at cash basis income, the total premiums earned would have to be adjusted for any year end timing differences and any uncollected premiums.

Since the method of determining total premiums earned is relatively simple, the area of most concern is primarily in the determination of uncollected premiums and any timing differences in the collection of payments on account. This is an area where books and records are often lacking. How the taxpayer tracks these outstanding bills, what collection procedures are used, and an approximation of the annual percentage of uncollected premiums should be determined during the initial interview. This should be followed up with an examination of whatever records the taxpayer has regarding these accounts receivable.

The weekly reports to the surety company provide a detailed listing of the bonds written for that reporting period. The amount of the bond and the premium earned are listed on a per bond basis along with the date the bond was written. This information is useful in determining the year end cutoff for income. The report will total the bond amounts and bond premiums, list the BUF payment amount, and list the exonerated bonds separately, usually at the bottom of the report.

Bond costs have not been used in this indirect method because some surety contracts have a \$5-\$10 per bond fee in addition to the percentage charge. This additional fee

is usually passed on to the client.

REIMBURSED EXPENSES

Bail agents may collect fees from the defendant or his or her guarantor for expenses they incur in tracking and retrieving a defendant for court appearances. Defendants are usually charged for travel, long distance phone calls, and court costs. Since the bail agent expenses these out-of-pocket costs, any reimbursements of these costs must be included in income. This applies to any Summary Judgment paid by the bail agent for which the bail agent is subsequently reimbursed by, or on behalf of, the defendant. The bail agent typically is required by state law to retain a copy of these additional charges and to provide a copy to the defendant.

COLLATERAL

Collateral which is held by the bail agent must be returned upon request of the defendant once the bail is exonerated. However, any collateral returned may be reduced by any uncollected premium or by any other outstanding charges. Thus, the amount retained would be income to the bail agent.

A revenue agent should take a position that if the bail agent receives collateral in lieu of all or part of the bond premium, then the portion of the collateral received in lieu of the bond premium is not a refundable deposit, but rather is taxable income to the bail agent upon receipt. For example, if a defendant pays a 10 percent bail premium by paying 8 percent in cash and posting collateral in the amount of an additional 7 percent in either cash or property, the bail agent has received income in the amount of the full 10 percent bail premium. The additional 5 percent received is treated as a refundable deposit.

According to past experience of examining agents, not returning collateral is an area of abuse by bail agents. Accordingly, the bank statements for the collateral account should be inspected to determine if the bail agent is using the account properly. That is, cash collateral should be deposited and returned on a timely basis. The only withdrawals should be for reimbursement of collateral and transfers into the operating account to be included in income in conjunction with reimbursement of expenses.

A large beginning balance in the collateral account should be investigated further. There could be several explanations for the balance. Collateral may have been retained to offset unpaid expenses or forfeitures. In such a case, the collateral should have been transferred to the operating account and included in income.

Some collateral is simply never claimed after bail has been exonerated, and some collateral is related to bail that has not yet been exonerated. In determining if the collateral in the latter two instances should be included in income, we must look at the specific facts and circumstances of each case.

Since collateral is returned only upon request of the defendant once he or she is exonerated, it can best be characterized as a refundable deposit. Although there are no specific court cases that have dealt with the collateral issue, case law relating to deposits indicates that deposits should not be included in income until the right to retain them is fixed. **Commissioner v. Indianapolis Power and Light Co.**, 493 U.S. 203 (1990); **Oak Industries v. Commissioner**, 96 T.C. 559 (1991).

In the bail bond industry, the only specific instance when a bail agent's right to retain collateral is fixed is when it is used to offset unpaid expenses associated with a specific bond. However, in the case of bail that has been exonerated, it can be argued that after a reasonable period of time, unclaimed cash collateral should be included in income.

If collateral in the bail agent's custody cannot be associated with specific bail bonds due to inadequate records, the revenue agent should take an initial position that the collateral should be included in income per IRC section 61. When cash collateral is commingled with operating funds, it takes on the same character and should be included in income, unless the taxpayer can substantiate the identity of the funds as cash collateral. If the taxpayer can establish the identity of the cash collateral, the collateral constitutes refundable deposits, irrespective of the fact that they are commingled with operating funds. See **Indianapolis Power and Light**, 493 U.S. 203; see also **Oak Industries**, 96 T.C. 559. Property such as automobiles, jewelry, TV's, VCR's, and deeds of trust are commonly taken as collateral. Searches of Department of Motor Vehicle records and county property records may provide information on property collateral that has been retained by the bail agent. Unexplained deposits into the operating account may be the result of sales of property used as collateral. The depreciation schedule may also include collateral that was retained.

BUF PAYMENT DEDUCTIONS

Payments made by bail agents into BUF accounts maintained by their surety companies are held as security for the agent's agreement to indemnify the surety company for any expenses incurred, including Summary Judgments, should the defendant fail to make court appearances as required by the bond. It has been observed that standard industry practice is to deduct these amounts when paid into the BUF account. Payments from this account for specific liabilities are often

deducted as well, resulting in a double deduction for the taxpayer.

At least one state has a statutory requirement that surety companies maintain a BUF account for agents who represent them. Thus, payments into this account are necessary in order for bail agents to conduct business in that state.

The issue is whether transfers to this account are deductible when paid. Case law has long followed the course that payments made for future liabilities are not deductible. **Leslie W. Sebring & Nanci M. Sebring v. Commissioner**, 93 T.C. 220 (1989). In **Sebring**, the court held that the payments into the BUF account were deposits held as security for payment of contingent liabilities and were disallowed as deductions. Only payments from this account for specific liabilities were deductible.

The court in **Sebring, supra**, pointed out that, on termination of the contract between the surety company and the bail agent, the surety company was contractually required to return the balance of the agent's BUF account to the agent after satisfaction of all outstanding liabilities. Thus, the bail agent retains any benefits from the account plus earned interest.

Payments made by bail agents for their BUF account, therefore, are not deductible since they are not payments for specific liabilities. Bail agents are often required by their surety company to pay specific liabilities from their own funds. These payments would be deductible as they are made.

TAX TREATMENT OF BOND COSTS

A bail agent pays a fee to the surety company which generally ranges from 1.2 to 1.5 percent of the face amount of the bond, or 12 to 15 percent of the bail premium earned by the bail agent. This fee represents the cost of the bond.

On a nationwide basis, the average life of a bond is 4 to 6 months, with 90 percent of all bonds falling within this category. However, the revenue agent should take the position that if the expected life of the bond exceeds 1 year, the associated bond costs are not currently deductible when paid, but must instead be amortized over the life of the bond. **Seaman v. Commissioner**, 84 T.C. 564, 587 (1985); Treas. Reg. section 1.461-1(a).

Thus, for example, if a bail agent pays \$30 for a bond, which is not exonerated until the following year, the \$30 payment has created an asset (the bail agent's contractual rights under the bond) with an expected life of 2 years. Accordingly, the fee is deductible ratably over the 2-year life of the bond. Conversely, if the life of a bond

does not extend substantially beyond the close of the taxable year, then a current deduction is appropriate. **Seaman**, 84 T.C. at 587.

The amounts paid by a bail agent to the surety company are similar to insurance payments made by automobile dealers in connection with extended service warranties. The Service has taken the position administratively that automobile dealers must amortize insurance payments over the life of an extended service warranty, even though the automobile dealer recognizes all of the income from the sale of the extended service warranty in the first year. See generally Rev. Proc. 92-97, 1992-2 C.B. 510. The same analysis can be applied to bail agents and the cost of bonds.

CHANGE IN ACCOUNTING METHOD

When it has been determined that the taxpayer is currently deducting his or her BUF payments and he or she has a beginning balance in that account, a prior period adjustment per IRC section 481 must be made. The change from deducting payments into the BUF account to not deducting such payments (and only deducting payments from the BUF for specific liabilities) is a change in accounting method. Treas. Reg. section 1.446-1 states that "the term 'method of accounting' includes not only the overall method of accounting of the taxpayer but also the accounting treatment of any item". Treas. Reg. section 1.481-1 prescribes the rules to be followed in computing taxable income due to a change in method of accounting. "A change in method of accounting to which section 481 applies includes a change in the over-all method of accounting for gross income or deductions, or a change in the treatment of a material item * * *. In computing taxable income for the taxable year of the change, there shall be taken into account those adjustments which are determined to be necessary solely by reason of such change in order to prevent amounts from being duplicated or omitted."

It has been observed in the bail industry that not only do bail agents deduct payments into the BUF accounts, but they often deduct withdrawals from this account for specific liabilities. Thus, there is a likelihood that deductions will be duplicated if the taxpayer deducts both payments into the BUF account and payments from the BUF account. If a bail agent is deducting payments into his or her BUF account, it must be assumed that prior years were treated the same, and, in order to account for this, the cumulative amount of previous deductions should be treated as a prior period adjustment per IRC section 481 and included in income to avoid a double benefit to the taxpayer.

The IRC section 481 adjustment is the total amount required to correct a taxpayer's cumulative overstatement of deductions, going back to the first taxable year in which

the taxpayer deducted payments to BUF accounts. Consider the following example:

Example 1

A taxpayer has been a bail agent for 10 years and cumulatively has paid \$100 into one or more BUF accounts during that period. The taxpayer deducted all of these payments currently. None of the \$100 paid into the BUF account was used to pay expenses or liabilities. The taxpayer has received a refund of \$60 due to the exoneration of some of the contracts. Therefore, the opening balance of the account is \$40. The taxpayer did not report the \$60 refund as income in the taxable year in which it was received. In this situation, the correct IRC section 481 adjustment is not \$40, but rather \$100 to reflect the cumulative amount deducted erroneously over the 10-year period.

The improper method of expensing the payments from the BUF account presents not only the potential for double deductions but also the potential for omitting income. **Graff Chevrolet Co. v. Campbell, Jr.**, 343 F.2d 568 (5th Cir. 1965) states that "when a taxpayer uses an accounting method which reflects an expense before it is proper to do so or which defers an item of income that should be reported currently, he has not succeeded (and does not purport to have succeeded) in permanently avoiding the reporting of any income; he has implicitly promised to report that income at a later date, when his accounting method, improper though it may be, would require it."

As this concept in **Graff Chevrolet, supra**, is applied to the BUF issue, the taxpayer, under his or her improper method of expensing the BUF payments when paid, would be required to include in income any distribution made to him or her from his or her BUF account when the surety contract is terminated and all outstanding liabilities have been satisfied. This is likely to be overlooked. Since the surety companies hold these BUF accounts in trust for the bail agents as the property of the bail agents, they do not issue Forms 1099 to the bail agents when they distribute the BUF proceeds to them upon termination of the contract.

Even if a bail agent currently represents only one surety company, he or she may still have BUF balances through other surety companies due to his or her prior affiliation with those companies. In determining the amount which should be included in the prior period adjustment, the revenue agent should include not only the beginning balance of the current BUF account, but also any other BUF account balances which are still maintained by the bail agent's former surety companies.

This page intentionally left blank.

INTERVIEW - BAIL BOND AGENTS

Power of attorney? List name, address, and phone number.

What is your full name?

What is your spouse's full name?

What is your correct Social Security Number?

What is your current address?

What is the extent of your education?

Have you filed federal tax returns for the past 10 years?

Have you amended your _____ federal tax return(s)?

Have you been audited by the state or by IRS during the last 5 years? If so, what were the issues? Please provide a copy of the audit report.

Have you filed any federal partnership, corporate, or fiduciary tax returns for the last 10 years?

BUSINESS HISTORY

How long have you worked in the bail bond business?

Are you a licensed bail agent? When did you become licensed?

Name(s) under which you have operated-

Employer's EIN-

Principal place of business-

Are there any other locations?

Do you own or rent the building where you conduct your business?

What surety company(s) have you been affiliated with and during what years?

Do you have or have you had any business partners during the past 5 years?

Did you purchase any bonds from any other agent?

Did any other bond agent purchase bonds from you?

How many employees did you have? Please name them and indicate what years they worked for you.

BOOKS AND RECORDS

Where are the books and records located?

What type of records are maintained? By hand or computer?

Who maintains those records?

Please describe the bail process in terms of who does what and what business records are generated, that is, what receipts are prepared, what reports are prepared, etc.

INCOME

How were gross receipts per return computed?

Approximately what percentage of income is received in cash?

How are cash transactions handled and by whom?

Are all cash receipts deposited?

How often?

Into what accounts? State name of bank, branch, and account number.

Who makes the deposits?

Who prepares the deposit slips?

Who opens the mail?

Who counts the cash?

Are receipt books maintained?

Are they pre-numbered?

Are numbers accounted for and used in sequence?

Do you collect the full amount of the premium up front?

Do you accept partial payment on premium?

If so, how do you account for or track subsequent payments?

Approximately what percentage of premiums per year are you unable to collect?

Did you have any years with any unusually large bad debts?

Do you use a collection agency?

EXPENSES

How are expenses paid? Check or cash?

By whom?

Did you pay any Summary Judgments? If so, what years? Did you make payment yourself or were the funds withdrawn from your BUF account? If so, were you required to reimburse your BUF account?

Were you reimbursed by your client for any Summary Judgments?

COLLATERAL

How is collateral handled? Separate bank account?

Cash

Property

FORM 8300

Are you aware of Form 8300 reporting requirements per IRC section 6050I?

Did you file any Forms 8300 during _____? Please provide copies for inspection.

- Were they timely submitted to the Data Center within 15 days after payment was received?
- Did you furnish a statement to the person who submitted the cash payment by January 31 of the succeeding calendar year?

OTHER QUESTIONS

Did you and/or your spouse maintain any bank accounts during the tax year?

If so, state name of bank, branch, account number, and type of account.

Did you or your wife maintain any safe deposit box during the last 5 years?

If so, state the location and the contents of the safe deposit box.

Have you or your spouse at any time during the last 5 years kept any currency in a safe deposit box? If so, provide an explanation.

What is the largest amount of cash or currency which you or your spouse have had at any time at your home, in a safe deposit box, or any other place other than on deposit in a bank?

How much cash or currency did you have on hand on January 1?

Did anyone else ever keep or hold for you, your spouse, or your children, cash, currency, or any money belonging to you, your spouse, or your children during the last 5 years?

Did you or your spouse purchase or sell any securities or real estate during ____? If so, state the following details:

<u>Description</u>	<u>Date acquired</u>	<u>Cost</u>	<u>Date sold</u>	<u>Selling price</u>
---------------------------	---------------------------------	--------------------	-----------------------------	---------------------------------

Did you or your spouse borrow any money during ____? If so, state the source, amount of the loan, and the date you received the money.

Did you or your spouse loan any money to any person for which you received payments during ____? If so, state the name of the individual, the current address, amount loaned, the date it was loaned, the outstanding balance, and the dates of any repayments.

Did you, your spouse, or your children receive any gifts, inheritances, or money from a trust fund during ____? If so, state the source, the amount or what you received, and the date received.

Any distributions from any partnerships or corporations?

Have you or your spouse made any investments or acquired any assets during ____ which have not been stated or explained by you already during this interview?

Has anyone as a nominee, or in favor of you, or in any way, held for you or your spouse any real property, personal property, cash, currency, or anything of value during the last 5 years? If so, provide an explanation.

Chapter 8

ESTABLISHING FRAUD

INTRODUCTION

To establish civil fraud, two facts must be proved: that the tax liability was understated; and that the understatement was due to deliberate intent to evade tax. To successfully establish fraud, one must look beyond the books and records and audit the taxpayer, not just his or her tax return.

UNDERSTATEMENT OF TAX

Several aspects of the bail bond industry increase the likelihood that not all income will be reported by the taxpayer on his or her tax return. The cash intensive nature of the business increases the likelihood that not all cash receipts will be deposited. Collateral such as automobiles, TV's, VCR'S, and jewelry that are retained by the bail agent are not likely to be accounted for properly. Real estate seized to pay a Summary Judgment is another example.

Several indirect methods should be used to demonstrate that income was omitted from the tax return. The percentage method based upon BUF payments provides a reliable indication of reportable income once adjustments are made for timing differences and uncollected premiums. However, it does not address the application of those funds. Where did the money go? Establishing how the unreported funds were applied gives additional credence to their existence.

This can be accomplished by applying a second indirect method. IRM 4231, text 834 through 838 provide detailed instructions on using the following methods: the Source and Application of Funds Method, the Net Worth Method, and the Bank Deposit Analysis. Each of these methods would enable the examiner to identify the use of funds. Which method is used depends on the facts of each case as well as how comfortable an agent is with a particular method.

A thorough asset search is a critical step in the income probe. This is not only because it is a step in the analysis of the source and application of funds, but it may also turn up previously concealed assets, particularly since the retention of collateral is a potential source of income. A search of Department of Motor Vehicle Records may turn up

vehicles that were used as collateral and retained by the bail agent. Acquisitions of real estate can be identified through county records. Verification of assets on the depreciation schedule may provide additional evidence. A tour of the taxpayer's residence or place of business may turn up assets not previously accounted for by the taxpayer.

FRAUDULENT INTENT

The methods of establishing a taxpayer's intent to evade tax are no different for taxpayers in this industry than for any other taxpayers. A person's intent must be inferred from his or her actions -- what he or she says and does. Therefore, it is crucial that the taxpayer's actions and interviews are well documented throughout the examination. IRM 4231, text 940 lists some of the more common "badges of fraud" that may be evidence of the taxpayer's intent to evade tax. The existence of these "badges" do not alone prove fraud, but they may signify that additional steps should be taken to obtain "clear and convincing evidence." Every effort should be made to obtain direct evidence such as false entries on books and records or altered documents. IRM 4231, text 951 through 962 cover requirements of proof and examination techniques in developing fraud issues.

The understatement of income in itself does not imply intent to evade tax, particularly when books and records are poor. The understatement could be due to mistakes, a difference of opinion with regard to the proper treatment of a particular item, reliance on professional advice, carelessness, or negligence. If the taxpayer's accounting background is limited, there may simply be a lack of comprehension in terms of the tax treatment of certain items.

If books and records are so poor that they are likely to be responsible for the misstatement of income, an Inadequate Records Notice as defined by IRM 4271 may be a more appropriate course of action than a fraud referral. Once the inadequate records have been so documented, the taxpayer has been put on notice of this deficiency. If he or she subsequently maintains poor books and records, this may be an indication that his or her intent is to evade tax. Thus a future fraud referral would be stronger.

Once an examiner determines that there is evidence of fraud, the Examination Division Fraud Coordinator should be consulted to ensure adequate evidence has been obtained before a fraud referral is made. Text 921 of IRM 4231 provides guidelines to be followed in determining whether a civil or criminal referral should be made. IRM 4565.2 gives instructions on how to prepare Form 2797, Referral Report for Potential Fraud Cases.

For returns due after December 31, 1989, the fraud penalty, IRC section 6663, only applies if a return has been filed. If the taxpayer has failed to file a return, and that failure can be shown to be fraudulent, IRC section 6651(f) provides for an increased failure to file penalty.

If the taxpayer has failed to file Forms 8300 to report cash transactions, or filed incorrect or incomplete Forms 8300, he or she may be subject to civil penalties under IRC section 6721.

If a criminal referral is considered, the following sanctions may apply to the misconduct discussed in this section. Failure to file either tax returns or Forms 8300, may be subject to criminal sanction under IRC section 7203. For this sanction to apply, the Government must prove beyond a reasonable doubt that the taxpayer was required to file a return, failed to file the return, and that the failure was willful. IRC sections 7201 (tax evasion) and 7206 (filing false returns) provide criminal sanctions for the filing of fraudulent returns. IRC section 7206 would also be applicable to the filing of a false Form 8300. The "beyond a reasonable doubt" standard applies to these sanctions as well.

This page intentionally left blank.

Chapter 9

FUTURE CONSIDERATIONS

There are some indications that surety companies may try to restructure or rename BUF accounts so that bail agents will be able to expense any payments to the surety companies. There are several points to consider. Also, as long as the purpose of a BUF account is ultimately to provide funds for future liabilities, and the balance of the account is refundable upon termination of the contract, the basic facts will stay the same and thus, payments into this account will not be deductible.

The first step in addressing Compliance 2000 is to identify areas of noncompliance in the bail bond industry. The potential areas of greatest concern to examiners are the possible existence of nonfilers, unreported income, and the possibility of deducting the BUF payments. Other potential areas include poor record keeping and noncompliance in filing information returns.

The most effective way to address nonfilers and unreported income issue is two-fold. The first is by advertising the fact that the IRS has developed an audit guide, with an indirect method of determining income, and which identifies the BUF payment issue. This may best be achieved through the surety companies since they could provide a broad coverage.

A local approach would be more appropriate in providing assistance in improving better record keeping and the filing of information returns. Contacts could be made through local networks, by mail, or both.