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STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date:	**04/18/13**	Bill No:	**Assembly Bill 781**
Tax Program:	**Sales and Use California Tire Fee eWaste Fee**	Author:	**Bocanegra**
Sponsor:	**BOE**	Code Sections:	**RTC 7153.6 & 55363.5**
Related Bills:		Effective Date:	**01/01/14**

BILL SUMMARY

This bill makes it a punishable offense for any person to knowingly sell, purchase, install, transfer or possess software programs that falsify reported sales.

Summary of Amendments

Since the previous analysis, the bill was amended to remove the felony classification, and make the criminal offense punishable by a fine up to $10,000 and/or three years imprisonment. The amendments also delete the provision that would have required the person found guilty to forfeit to the state all profits associated with these devices use.

ANALYSIS

CURRENT LAW

Existing California law[1] sanctions taxpayers who intentionally fail to accurately report and remit tax and fee liabilities. In addition to a variety of civil penalties, the law imposes criminal penalties for violations. For example, any person who makes a fraudulent return with the intent to evade the determination of an amount due, or any person who assists in the preparation or presentation of a document that is false to a material matter is guilty of a misdemeanor, punishable by a fine of at least $1,000 and not more than $5,000, or imprisonment up to one year in the county jail, or both fine and imprisonment in the court's discretion. In addition, the law makes it a felony if the unreported tax liability is at least $25,000 in a consecutive 12-month period, and is punishable by a fine of at least $5,000 and not more than $20,000, or imprisonment for 16 months, or 2 or 3 years, or both the fine and imprisonment in the discretion of the court.

The existing Fee Collection Procedures Law[2] (FCPL) generally provides for the administration and collection of BOE-administered fees. Legislation that establishes a new fee may reference the FCPL with minimal verbiage. Among other things, this law includes collection, reporting, refund, and appeals provisions, and, similar to the Sales and Use Tax Law, provides criminal penalties for violations.

Existing law does not specifically penalize a person for the sale, purchase, installation, transfer, or possession of sales suppression devices or software that conceals or removes sales transactions from retailers' recordkeeping systems.

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[1] Revenue and Taxation Code (RTC) Sections 7152 through 7157.
[2] Part 30 of Division 2 (commencing with Section 55001) of the RTC.

PROPOSED LAW

This bill makes it a criminal offense for any person to knowingly sell, purchase, install, transfer, or possess in this state any automated sales suppression device, zapper or phantom-ware (devices), as defined. The offense is punishable by a fine of up to $10,000 and imprisonment in the county jail for not more than one year, or, 16 months, as specified, or two or three years, or both that fine or imprisonment.

The bill applies to the Sales and Use Tax Law, and the California Tire Fee and Covered Electronic Waste Recycling Fee, which are fees imposed on consumers at the retail level.

The bill specifies that the person shall also be liable for the taxes and fees, interest, and penalties due.

The bill defines "automated sales suppression device," "zapper," "electronic cash register," "phantom-ware," and "transaction data."

BACKGROUND

California's tax system is based on voluntary compliance. Most tax or feepayers (taxpayers) who report taxes and fees to the BOE are honest and generally comply with the law. However, some seek to skim or hide their sales to evade the tax due. Some cash-based businesses, for example, do not ring up all their sales through their cash register, keep two sets of books, or simply file false tax returns.

Now, an electronic method to skim sales allows retailers to conceal or remove sales transactions from recordkeeping systems. These devices are referred to as "sales suppression devices," and the software is referred to as "phantom-ware." The use of this technology makes the detection of understated sales difficult in tax and fee audits.

COMMENTS

1. **Sponsor and purpose.** As sponsors of this bill, the BOE Members believe that California must be proactive and curtail the use of these sales suppression devices. Use of this technology not only defrauds the state, but provides users an unfair competitive advantage over taxpayers who comply with the law and pay their fair share of taxes and fees. The Legislature has recognized through its enactment of criminal penalties for deliberate taxpayer fraud and evasion that criminal sanctions play an important role in tax administration. Specifically criminalizing and punishing the sale, installation, and use of sales suppression devices serve as a strong deterrent to potential offenders.

2. **Other states have banned these devices and software.** In 2011, Georgia became the first state to make it a crime to knowingly sell, purchase, install, transfer, or possess any automated sales suppression device or zapper or phantom-ware. Several other states have enacted similar provisions, including Connecticut, Michigan, Louisiana, Maine, Tennessee, and West Virginia. Others, including Indiana and New York, have proposed legislation outlawing these devices and software.

3. **Specific incidents of sales suppression software cases.** According to information obtained from the Federation of Tax Administrators' (FTA) website, examples of United States zapper cases involving substantial underreported sales include :

- Connecticut: The IRS discovered in an income tax audit that a grocery store had $17 million in underreported sales.
- Michigan: The CIA uncovered information from a restaurant chain owner's relative that the restaurant neglected to report $20 million in sales.
- Ohio: The FBI and the Joint Terrorism Task Force detected that a restaurant chain underreported $3 million in sales.
- New York: A *New York Post* article disclosed an undercover sting operation where 70 percent of electronic cash register sellers had tried selling zapper software with the systems they offered to potential customers.

COST ESTIMATE

The administrative costs are absorbable.

REVENUE ESTIMATE

Currently, the BOE staff is studying the extent of California's sales suppression software problem in California. Based on BOE data for 2010, California's dining and beverage industry reported taxable sales of $51.3 billion. Using a 5% underreporting rate, California loses $214 million[3] annually due to use of these sales suppression devices.

If enacted, we anticipate these estimated losses will decrease. However, the extent of the decrease is unknown.

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[3] Based on California's average 2013 state, local, and district tax rate of 8.38%.