Add Revenue and Taxation Code Sections 7153.6 and 55363.5 to the Sales and Use Tax Law and Fee Collections Procedures Law, respectively, to specify that any person who knowingly sells, purchases, installs, transfers or possesses software programs that falsify electronic sales records is guilty of a felony and subject to applicable criminal penalties.

Source: Sales and Use Tax Department

Existing Law. The Revenue and Taxation Code (RTC) sanctions taxpayers who fail to comply with the law when they report and remit tax and fee liabilities. In addition to a variety of civil penalties, the RTC imposes criminal penalties for violations. For example, under Sections 7152 and 7153 of the Sales and Use Tax Law, 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, Section 7153.5 provides that the crime is 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 (FCPL) generally provides for the administration and collection of BOE-administered fees. It was added to the RTC to allow bills establishing a new fee to reference it with minimal verbiage. Among other things, the FPCL 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.

This Proposal. This proposal makes it a felony for any person to knowingly sell, purchase, install, transfer, or possess in this state any automated sales suppression device, zapper or phantom-ware, as defined. The crime is punishable by a fine of up to $100,000 and imprisonment for not less than 1 year or more than 5 years. This provision would be incorporated into the Sales and Use Tax Law and the FPCL.

Background. California's tax system is based on voluntary compliance. Most taxpayers who report tax 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.

Scofflaws have developed an electronic approach to skimming sales, which conceals or removes sales transactions from recordkeeping systems at or close to the point of sale. These devices are referred to as "sales suppression devices," and the software is referred to as "phantomware." The use of this technology makes detecting understated records of sales difficult. 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.

According to Richard Ainsworth, a tax attorney and Boston University School of Law professor who has researched sales suppression devices extensively, these devices are widely used in European countries and Canada. Additionally, use of these devices has spread to the United States. Georgia, Louisiana, Maine, Michigan, Tennessee, Utah, and West Virginia have passed legislation, and several more, including Illinois and New York, have proposed legislation outlawing these devices and software.[1]

The BOE currently is conducting an informal study to estimate the extent of the sales suppression software problem and how it affects California sales tax reporting. The Federation of Tax Administrators' (FTA) website includes a table of estimated state losses.[2] Under the FTA's methodology, California's estimated loss from the use of sales suppression software amounts to $2.8 billion per year.

Using BOE data, California's annual revenue loss is $214 million. This number is calculated by multiplying California restaurant taxable sales of $51.3 billion by 5% and then multiplying the product by the average statewide tax rate of 8.37%.

This proposal would bring California in line with other states that have passed or proposed similar legislation.

By amending the FCPL, the proposal also would apply to the California Tire Fee and Covered Electronic Waste Recycling Fee, which are fees imposed on consumers at the retail level.

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 would serve as a strong deterrent to potential offenders.

Section 7153.6 is added to the Revenue and Taxation Code, to read:

7153.6. (a) Notwithstanding any other provision of this part, a person who knowingly sells, purchases, installs, transfers, or possesses in this state any automated sales suppression device or zapper or phantom-ware is guilty of a felony and shall be punished by a fine of not more than $100,000 and imprisonment for not less than 1 year or not more than 5 years. In addition, the person shall be liable for all taxes, interest and penalties due as the result of the use of an automated sales suppression device or zapper or phantom-ware and shall forfeit to the state all profits associated with the sale or use of an automated sales suppression device or zapper or phantom-ware.

(b) For purposes of this section:

(1) "Automated sales suppression device" or "zapper" means a software program carried on a memory stick or removable compact disc, accessed through an internet link, or accessed through any other means, that falsifies the electronic records of electronic cash registers and other point-of-sale systems, including, but not limited to, transaction data and transaction reports.

(2) "Electronic cash register" means a device that keeps a register or supporting documents through the means of an electronic device or computer system designed to record transaction data for the purpose of computing, compiling, or processing retail sales transaction data in whatever manner.

(3) "Phantom-ware" means a hidden, preinstalled, or installed at a later time programming option embedded in the operating system of an electronic cash register or

[2] The losses are based on a ratio of the estimated losses in Quebec compared to Quebec's Gross Domestic Product (GDP) that is applied to the states' GDP.

hardwired into the electronic cash register that can be used to create a virtual second till or may eliminate or manipulate transaction records that may or may not be preserved in digital formats to represent the true or manipulated record of transactions in the electronic cash register.

(4) "Transaction data" includes information regarding items purchased by a customer, the price for each item, a taxability determination for each item, a segregated tax amount for each of the taxed items, the amount of cash or credit tendered, the net amount returned to the customer in change, the date and time of the purchase, the name, address, and identification number of the vendor, and the receipt or invoice number of the transaction.

Section 55363.5 is added to the Revenue and Taxation Code, to read:

55363.5. (a) Notwithstanding any other provision of this part, a person who knowingly sells, purchases, installs, transfers, or possesses in this state any automated sales suppression device or zapper or phantom-ware is guilty of a felony and shall be punished by a fine of not more than $100,000 and imprisonment for not less than 1 year or not more than 5 years. In addition, the person shall be liable for all fees, interest and penalties due as the result of the use of an automated sales suppression device or zapper or phantom-ware and shall forfeit to the state all profits associated with the sale or use of an automated sales suppression device or zapper or phantom-ware.

(b) For purposes of this section:

(1) "Automated sales suppression device" or "zapper" means a software program carried on a memory stick or removable compact disc, accessed through an internet link, or accessed through any other means, that falsifies the electronic records of electronic cash registers and other point-of-sale systems, including, but not limited to, transaction data and transaction reports.

(2) "Electronic cash register" means a device that keeps a register or supporting documents through the means of an electronic device or computer system designed to record transaction data for the purpose of computing, compiling, or processing retail sales transaction data in whatever manner.

(3) "Phantom-ware" means a hidden, preinstalled, or installed at a later time programming option embedded in the operating system of an electronic cash register or hardwired into the electronic cash register that can be used to create a virtual second till or may eliminate or manipulate transaction records that may or may not be preserved in digital formats to represent the true or manipulated record of transactions in the electronic cash register.

(4) "Transaction data" includes information regarding items purchased by a customer, the price for each item, a taxability determination for each item, a segregated tax or fee amount for each of the items subject to the tax or fee, the amount of cash or credit tendered, the net amount returned to the customer in change, the date and time of the purchase, the name, address, and identification number of the vendor, and the receipt or invoice number of the transaction.