

**DEPARTMENT OF TAXATION
2014 Fiscal Impact Statement**

REVISED 1/20

1. **Patron** Mark L. Keam

3. **Committee** House Courts of Justice

4. **Title** Miscellaneous Taxes; Automated Sales
Suppression Devices

2. **Bill Number** HB 829

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. Summary/Purpose:

This bill would prohibit and designate as a Class 6 felony the willful and knowing sale, purchase, installation, transfer or possession in Virginia of automated sales suppression devices, known as “zappers,” or “phantom-ware.” The bill would also impose a civil penalty of \$10,000.00, which would be dedicated to the General Fund. In addition, any person who violated the proposal would be liable for all taxes and penalties due to Virginia as a result of the fraudulent use of an automated sales suppression device, and would need to disgorge all profits associated with the sale or use of the device. The bill would also grant the Tax Commissioner the discretion to revoke or suspend the certificate of registration of any person convicted of violating the prohibition. Finally, the bill would suspend the statute of limitations on the assessment and collection of taxes, penalties, and interest attributable to the use of automated sales suppression devices.

Under current law, retailers that make a false or fraudulent return with intent to evade the sales and use tax are guilty of a Class 1 misdemeanor, and subject to a maximum of one year in jail, a fine of not more than \$2,500, or both. In addition, they are subject to a civil penalty of 50% of the tax assessed.

The effective date of this bill is not specified.

This is a Department of Taxation bill.

6. **Budget amendment necessary:** No.

Item 385, Department of Corrections of the Introduced Executive Budget provides for the cost of incarceration.

7. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

8. Fiscal implications:

Administrative Costs Impact

Department of Taxation

The Department of Taxation (“the Department”) considers implementation of this bill as “routine,” and does not require additional funding.

Virginia Criminal Sentencing Commission

Because a violator of this provision could be sentenced to up to five years in prison, this bill could result in an increase in the number of persons sentenced to jail or prison. There is not enough information available to reliably estimate how many additional inmates in jail could result from this proposal. Any increase in jail population will increase costs to the state. The Commonwealth presently pays \$12.00 a day for each state responsible inmate. It also funds a considerable portion of the jails’ operating costs, e.g., correctional officers. The state’s share of these costs on a per prisoner, per day basis varies from locality to locality. However, according to the Compensation Board’s most recent Jail Cost Report (November 2013), the estimated total state support for local jails averaged \$30.06 per inmate, per day in Fiscal Year 2012.

By defining new Class 6 felony offenses, the proposal may increase the state responsible (prison) bed space needs of the Commonwealth. Similarly, the legislative proposal may have an impact on local adult correctional facilities’ bed space needs. Pursuant to § 30-19.1:4, the estimated amount of the necessary appropriation cannot be determined for periods of imprisonment in state adult correctional facilities; therefore Chapter 806 of the 2013 Acts of Assembly requires the Virginia Criminal Sentencing Commission to assign a minimum fiscal impact of \$50,000. Pursuant to § 30-19.1:4, the estimated amount of the necessary appropriation cannot be determined for periods of commitment to the custody of the Department of Juvenile Justice. The Governor’s Introduced Executive Budget provides for the minimum \$50,000 cost of the criminal penalty.

Revenue Impact

To the extent that there are retailers in Virginia utilizing sales suppression software that are found guilty, charged with civil penalties, and required to remit taxes, penalties, and other fees associated with the use of the sales suppression device, this bill would increase General Fund revenues by an unknown amount. To date, there is little data regarding the use of sales suppression devices in the United States and the impact such use has had on state tax coffers. Further, because the offense would be a new one, there is no history available to enable the projection of how much revenue might be collected.

9. Specific agency or political subdivisions affected:

Department of Taxation
Department of Corrections

10. Technical amendment necessary: No.

11. Other comments:

Sales Suppression Devices, Generally

Tax fraud, through the use of automatic sales suppression devices is increasingly posing a threat to tax revenue, both in the United States, and in other countries, including Germany, Brazil, Quebec, the Netherlands, and Sweden.

Retailers may utilize zappers to alter the records of their electronic cash records using software programs carried on memory sticks, removable compact discs, or through Internet links that falsify the electronic records of electronic cash registers and other point-of-sale systems. Some zappers may completely remove records of cash transactions, renumber remaining transactions, and generate a new control number for each transaction. Because they are physically kept apart from the systems they manipulate, zappers minimize risk of detection. Contrarily, phantom-ware is programming placed within a modern electronic cash register system that can be used to hide the skimming of cash sales. This feature reprograms electronic cash registers and point-of-sale systems so that selected types of cash transactions are not recorded. In either case, fraudulent retailers will collect the proper amount of sales tax, but report and remit a lesser amount to the state's revenue department to reflect the amount reported on their fraudulent till.

Given the difficulty of detecting zapper use and the fact that most state statutes criminalizing zapper use have only recently been enacted, there are only a few reported zapper cases in the United States.

Penalties for Tax Fraud and Statute of Limitations in Virginia

Under current law, retailers that: 1) fail or refuse to file a return, 2) make a false or fraudulent return with intent to evade the sales and use tax, 3) make a false or fraudulent claim for refund, or 4) give or knowingly receive a false or fraudulent exemption certificate are guilty of a Class 1 misdemeanor, and subject to a criminal penalty of one year in jail or a fine of not more than \$2,500 or both. In addition, they are subject to a civil penalty of 50% of the tax assessed.

Generally, tax must be assessed within three years from the date on which the return should have been filed. For false or fraudulent returns with the intent to evade payment of any tax or failure to file a required return, the taxes may be assessed or a proceeding in court may be begun for the collection of the taxes at any time within six years from the last day on which the return would have been due.

Other States

In the last few years, several states have enacted legislation banning the possession, ownership, or transfer of automated sales suppression devices and imposing penalties upon violators, as provided in the chart below:

State	Punishment	Fine	Additional Information
California	1-3 years	Up to \$10,000	Liable for taxes/penalties/interest
Connecticut	1-5 years	Up to \$100,000	Liable for taxes/ penalties/interest; forfeits all profits.
Georgia	1-5 years	Up to \$100,000	Liable for taxes/penalties/interest; forfeits all profits.
Illinois (effective 1/1/14)	2-5 years (Class 3 felony)	Class 3 felony	Class 3 felony
Indiana	2-8 years (Class C felony)		
Louisiana	Up to 5 years	Up to \$5,000	N/A
Maine	-Up to 5 years for possession/purchase/ownership; (Class C crime). -364 days for manufacturer/seller/installer (Class D crime).		Amnesty period to reduce penalties for those who correct and fully report previously underreported amount.
Michigan	1-5 years	Up to \$100,000	Liable for taxes/penalties/interest; forfeits all profits.
North Carolina	4-25 months (Class H felony)	Up to \$10,000	Liable for taxes/fees/penalties/interest; forfeit all profits
North Dakota	-Up to 10 years (Class B felony (first offense)) -Up to 20 years (Class A felony (second offense))	Up to \$100,000 for second offense	Possession for legitimate use is a defense. Liable for taxes at double amount/penalties/interest; forfeits all profits
Oklahoma	1-5 years	Up to \$100,000	Additional administrative fine of \$10,000, deposited into the General Fund. Revocation of sales tax permit for period of ten years.
Tennessee	N/A	Up to \$100,000	Possession for legitimate use is a defense. Protects confidentiality of persons who report violations in good faith.
Utah	-Up to 5 years (Third degree felony); -1-15 years (Second degree felony), second or subsequent offense	Up to twice the amount of the applicable taxes due.	Liable for taxes/penalties/interest; forfeits all profits.
Vermont	1-5 years	Up to \$100,000	Liable for taxes/penalties/interest; forfeits all profits. Safe harbor for voluntary disclosure.
Washington	5 years (Class C felony)	Seller/designer—Greater of \$10,000 or tax owed	Department of revenue may revoke purchaser business license and subject to five years of electronic monitoring.
West Virginia	5 years	\$10,000 to \$100,000	Liable for taxes/penalties/interest; forfeits all profits
Wyoming	Up to 3 years	Up to \$5,000	N/A

Proposal

This bill would prohibit and designate as a Class 6 felony the willful and knowing sale, purchase, installation, transfer or possession in Virginia of automated sales suppression devices, known as “zappers,” or “phantom-ware.” Under the terms of the bill, “automated sales suppression device” would include: 1) any software program, carried on a memory stick or removable compact disk, 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, or 2) any programming option embedded in the operating system of an electronic cash register, whether hidden, preinstalled, or installed at a later time, capable of being

used to create a virtual electronic cash register or eliminate or manipulate transaction records in order to omit suppressed sales transactions when representing the record of transactions in the electronic cash register, whether or not the true or manipulated records are preserved in digital or other formats.

Any person convicted of violating this provision would be guilty of a Class 6 felony, and subject to a punishment of one to five years imprisonment, or, at the discretion of the jury or the court trying the case without a jury, 12 months in jail and a fine of not more than \$2,500, either or both. This is in addition to any charges that may be imposed against the taxpayer under current law for making a false or fraudulent return with intent to evade the sales and use tax, a Class 1 misdemeanor, which carries a maximum one year jail sentence and a fine of not more than \$2,500.

The bill would also impose a civil penalty of \$10,000.00, which would be collected and assessed by the Department of Taxation in the same manner as other taxes are collected, and would be dedicated to the General Fund.

In addition, any person who violated the proposal would be liable for all taxes and penalties due to Virginia as a result of the fraudulent use of an automated sales suppression device, and would need to disgorge all profits associated with the sales or use of the device.

The bill would also give the Tax Commissioner the discretion to revoke or suspend the certificate of registration of any person convicted of violating the prohibition. The Commissioner would need to provide the taxpayer with 10 days' written notice of a hearing to allow the taxpayer to demonstrate why his certificate should not be revoked or suspended.

Finally, the bill would suspend the statute of limitations on the assessment and collection of taxes, penalties, and interest attributable to the use of automated sales suppression devices.

The effective date of this bill is not specified.

Similar Legislation

Senate Bill 611 is identical to this bill.

cc : Secretary of Finance

Date: 1/20/2014 KP
DLAS File Name: HB829F161