Senate Fiscal Agency
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BILL ANALYSIS

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Senate Bills 768 and 769 (as reported without amendment) *(as passed by the Senate)*
Sponsor: Senator John Pappageorge
Committee: Judiciary

Date Completed: 11-21-11

RATIONALE

An automated sales suppression device, sometimes known as a "zapper", and computer software known as "phantom-ware", are high-tech mechanisms for artificially reducing a business's sales record. Zappers or phantom-ware manipulate the record of point-of-sale cash receipts on an electronic cash register to show fewer or less-expensive sales than actually occurred. Using the devices enables a business to pay less in taxes to a state or other taxing jurisdiction than the amount that legally is due. The availability of zappers and phantom-ware apparently is quite widespread and their use has been uncovered in a few states, Quebec, and some European countries. It has been suggested that the transfer, installation, and possession of these devices should be prohibited in Michigan and subject to criminal penalties.

CONTENT

Senate Bill 768 would amend the Michigan Penal Code to do the following:

- **Prohibit the sale, purchase, installation, transfer, or possession of any "automated sales suppression device", "zapper", or "phantom-ware".**
- **Subject a violator to liability for taxes and felony penalties.**
- **Require a violator to disgorge all profits associated with the sale or use of the banned device.**
- **Allow an automated sales suppression device or phantom-ware to be seized without process.**

Senate Bill 769 would amend the Code of Criminal Procedure to include the felony proposed by Senate Bill 768 in the sentencing guidelines.

Senate Bill 769 is tie-barred to Senate Bill 768.

The bills would take effect 90 days after their enactment.

Senate Bill 768

Under the bill, a person could not knowingly sell, purchase, install, transfer, or possess any automated sales suppression device, zapper, or phantom-ware. A violation would be a felony requiring imprisonment for not less than one year or more than five years. A violator also could be fined up to $100,000.

A person who violated the bill would be liable for all taxes and penalties due to the State as the result of the fraudulent use of an automated sales suppression device or phantom-ware, and would have to disgorge all profits associated with the sale or use of the device.

An automated sales suppression device or phantom-ware, and any device containing an automated sales suppression device or phantom-ware, would be contraband and could be seized without process by any police officer.

"Automated sales suppression device" or "zapper" would mean a software program carried on a memory stick or removable compact disc, accessed through an internet link or any other means, that falsifies the electronic records of electronic cash registers and other point-of-sale systems including transaction data and transaction reports.

"Phantom-ware" would mean a hidden or installed 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 format to represent the true or manipulated record of transactions in the electronic cash register.

Senate Bill 769

Under the bill, selling or possessing an automated sales suppression device, zapper, or phantom-ware would be designated in the sentencing guidelines as a Class E felony against the public order, with a statutory maximum sentence of five years' imprisonment.

Proposed MCL 750.411w (S.B. 768)
MCL 777.16t (S.B. 769)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

A faculty member at the Boston University School of Law has done extensive research on the issue of technology-assisted sales suppression and its implications for taxing jurisdictions' collection of revenue. The Senate Judiciary Committee received copies of a presentation he made on the topic at the National Conference of State Legislatures' legislative summit in San Antonio in August 2011. That presentation demonstrated how zappers and phantom-ware work to underreport sales and generate reduced taxes, and examined several cases in which fraud charges had been pursued. Reportedly, when police in New York set up a sting operation in a what appeared to be a chain restaurant and advertised for the purchase of electronic cash registers, 17 of 19 potential vendors offered to include a zapper. In one prominent case in southeastern Michigan, the owner of a restaurant chain allegedly underpaid $20 million in taxes over a four-year period and diverted that money to Lebanon to help fund Hezbollah. A broad investigation of restaurants in Quebec estimated a loss of $425 million in tax revenue. Based on a comparison of Michigan's gross domestic product (GDP) to Quebec's GDP, if the same level of fraud occurred in Michigan, it would equate to an approximate loss of $740 million in tax revenue in Michigan just from restaurants that underreported sales. Zappers and phantom-ware can be used, however, in any business that conducts point-of-sale cash transactions using an electronic cash register.

When a business uses a zapper or phantom-ware to manipulate sales records, the State's taxpayers suffer financial harm. This underreporting of sales figures can result in reduced revenue from sales taxes, business taxes, and income taxes. Revenue from those sources is used to pay for a wide array of governmental services including education, public health, safety, and welfare, so the public is short-changed when the devices are used to falsify sales. In addition, when somebody scams the system to pay less in taxes than what is actually due, other taxpayers ultimately have to pay a little more to fund public services. Michigan law should discourage the use of these devices and penalize those who traffic in and use them.

Supporting Argument

The bill would provide an opportunity for Michigan to collect tax revenue due to the State in a more accurate and efficient manner. It presents an opportunity to raise revenue without enacting a tax increase.

Supporting Argument

It is possible that a business owner or manager could possess and use a zapper or phantom-ware unwittingly, so the bill would subject a person to the proposed penalties only if he or she *knowingly* bought, sold, transferred, installed, or possessed such a device. A person could buy an electronic cash register without knowing that a zapper was attached or phantom-ware was installed, for instance, or a franchise owner might get an affected cash register from a business chain's corporate office without knowing that someone put a zapper in the register or programmed phantom-ware into it.

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

The bills would have an indeterminate fiscal impact on State and local government. There are no data to indicate how many offenders would be convicted of the proposed offense. An offender convicted of the Class E offense under the bills would receive a sentencing guidelines minimum sentence range of 0-3 months to 24-38 months. Local governments would incur the costs of incarceration in local facilities, which vary by county. The State would incur the cost of felony probation at an annual average cost of $2,500, as well as the cost of incarceration in a State facility at an average annual cost of $34,000. Additional penal fine revenue would benefit public libraries.

Fiscal Analyst: Matthew Grabowski

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