Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bills 768 and 769 (as enacted)
Sponsor: Senator John Pappageorge
Senate Committee: Judiciary
House Committee: Commerce

PUBLIC ACTS 146 & 147 of 2012

Date Completed: 8-27-13

RATIONALE

Automated sales suppression devices, sometimes known as "zappers", and computer software known as "phantom-ware", are high-tech mechanisms for artificially reducing a business's sales record. Zappers and 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 was suggested that the transfer, installation, and possession of these devices be prohibited in Michigan and subject to criminal penalties.

CONTENT

Senate Bill 768 amended 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.**

Senate Bill 769 amended the Code of Criminal Procedure to include the felony enacted by Senate Bill 768 in the sentencing guidelines.

Senate Bill 769 was tie-barred to Senate Bill 768. The bills took effect on August 29, 2012.

Senate Bill 768

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

A person who violates the bill is 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 must disgorge all profits associated with the sale or use of the device.

The bill defines "automated sales suppression device" or "zapper" as 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" means 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 is a Class E felony against the public order, with a statutory maximum sentence of five years' imprisonment.

MCL 750.411w (S.B. 768)
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

Several years ago, a faculty member at the Boston University School of Law did 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 suffers a financial loss and its residents are harmed. 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 shortchanged 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. It is appropriate for Michigan law to ban the use of these devices and penalize those who traffic in and use them.

Supporting Argument

The bills provide an opportunity for Michigan to collect tax revenue due to the State in a more accurate and efficient manner, as well as raise revenue without enacting a tax increase.

Supporting Argument

It is possible that a business owner or manager might possess and use a zapper or phantom-ware unwittingly, so the bills subject a person to penalties only if he or she *knowingly* buys, sells, transfers, installs, or possesses such a device. A person might buy an electronic cash register without knowing that a zapper is attached or phantom-ware is installed, for instance, or a franchise owner might get an affected cash register from a business chain's corporate office unaware that someone put a zapper in the register or programmed phantom-ware into it.

Legislative Analyst: Patrick Affholter

FISCAL IMPACT

The bills will have an indeterminate fiscal impact on State and local government. There are no data to indicate how many offenders will be convicted of the new offense. An offender convicted of the Class E offense under the bills will receive a sentencing guidelines minimum sentence range of 0-3 months to 24-38 months. Local governments incur the costs of incarceration in local facilities, which vary by county. The State will 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 will benefit public libraries.

The State also may realize an indeterminate fiscal benefit due to the collection of any fraudulently avoided taxes, as well as taxes that might otherwise be unpaid.

Fiscal Analyst: Dan O'Connor

A1112\s768ea