Zappers: What's New in Electronic Sales Suppression

FTA Technology Conference
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Executive Summary

Background:

- Tax cheats have been skimming cash from the receipts of businesses in various fashions for years

Problem:

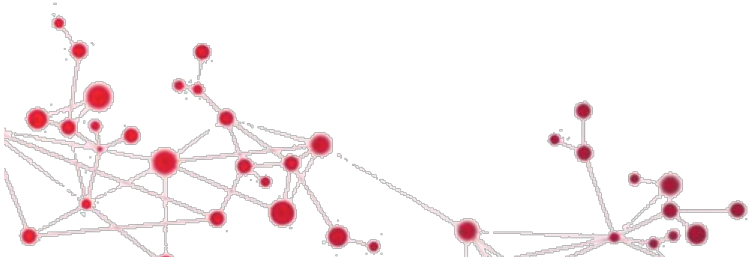
- Technology has allowed this skimming to become fast, easy, and extremely hard to detect which is costing states **hundreds of millions of dollars annually**

Historical Solution:

- Government tax agencies adding additional audit resources to combat the problem

Technology Solution Available:

- Use of technology to place an electronic lockbox at the business location that has proven to dramatically reduce non-compliance and increase revenues"



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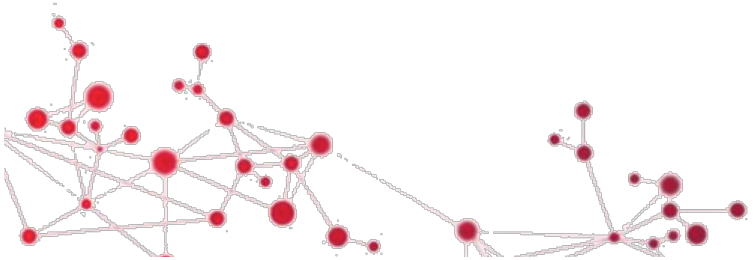
Agenda

- Historical View of Skimming
- Quick Review of Zappers
- Zappers in the US?
- Recent News and Legislation
- Detecting Sales Suppression Devices
- Revenu Québec's Solution and Results
- Implementation Approach
- Questions



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Historical Skimming Techniques

- Open drawer – not entering all the transactions into the cash register or point of sale system
- Two sets of books: One for personal records and another in case of audit
- Accurate books but filing false returns
- Reprinting the same invoice
- Training mode
- Cancel the transaction after cash is received
- Discount or coupon

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What is a Zapper?

- Computer function that facilitates tax evasion
- Typically creates two sets of books
- Owner avoids sales/income tax on the deleted receipts, while keeping the sales taxes collected from consumers
- Cash based businesses are the highest users of the software (restaurants, bars, convenience stores, etc.)
- Receipts are renumbered
- Flash drives, removable CDs, or accessed through the internet

Sales Suppression as a Service (SSaS)

- New service being offered to businesses
- Installer provides the service to its customers
  - Erase, purge, delete, crash or physically destroy the hard drive on a regular basis
- ECR/POS installer maintains access to system
- Manipulation service is provided remotely
- Installer maintains an accurate set of books in a remote location, which is often located in another state
- Becoming the new norm in the zapper community

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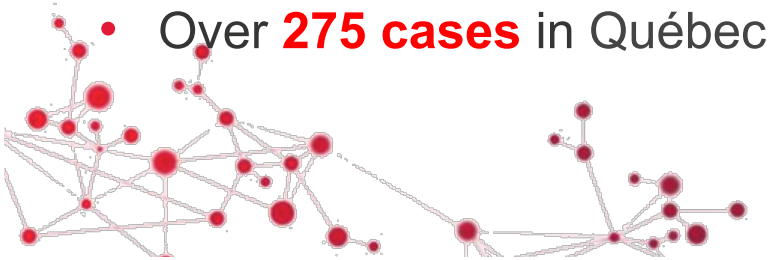
Are zappers being used in the US?

YES!! Traditional methods of skimming are certainly being used but below are some examples of zappers that have been detected in the US:

- **New York**
  - NY Dept. of Taxation personnel posing as new restaurant owners
  - 90% of ECR/POS salespeople tried selling zapper software with ECR/POS system
- **California**
  - Undercover footage of zappers being used
- **Connecticut** – $17 million by a grocery store
  - IRS Income Tax Audit
- **Michigan** – $20 million by a restaurant chain
  - Sister-in-law informed CIA
- **Ohio** – $3 million by a restaurant chain
  - FBI, Joint Terrorism Task Force, Homeland Security
- Over **275 cases** in Québec



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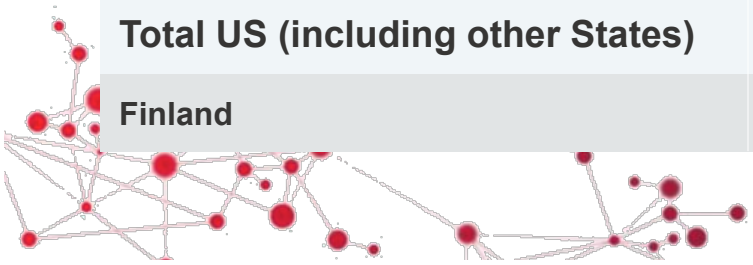
Estimated Annual Revenue Loss

State	Number of Restaurants	Estimated Restaurant Loss	Estimated Conv. Store Loss
California	62,469	$287.2M	$83.8M
Georgia	16,081	$39.4M	$18.4M
Illinois	25,193	$96.5M	$28.7M
Indiana	11,309	$48.5M	$22.0M
Louisiana	8,129	$34.8M	$9.0M
Michigan	15,729	$57.9M	$29.4M
Minnesota	9,767	$41.2M	$17.9M
New York	42,610	$231.8M	$72.3M
Pennsylvania	24,628	$90.6M	$27.0M
Utah	4,320	$15.7M	$8.3M
Total US (including other States)	**503,500**	**$2,315.0M**	**$1,133.7M**
Finland	9,731	$143.2M	N/A



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Recent News in this Area

California

- Audit Unit that is dedicated to the issue
  - Studying the restaurant industry
  - Studying the ECR/POS systems in depth
  - Found both internal (phantom-ware) and external (zappers) devices
  - Undercover footage of sales suppression taking place

Sales Suppression Symposium (April 2014)

- Representatives from 23 states and Canada attended

Quebec

- Expanding the SRM solution into the bar industry
- Revenu Quebec Moves to Record Drink Sales in Bars

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Recent News in this Area

Oklahoma

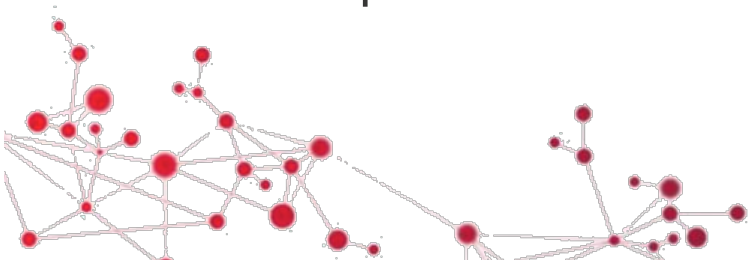
- Releases audit results of convenience stores
  - "Most owe at least $300,000 to $400,000"
  - Mom and Pop C-Stores sue Oklahoma Tax Commission

Illinois

- Fraud investigation on gas station owners
  - 27% of owners had skimmed over the past four years with some being over $1M per year
  - Sales Tax Zapped by Tax Zappers

Washington

- Passed legislation that included language that a business would be required to use an electronic monitoring device for five years if they wanted their business permit reinstated



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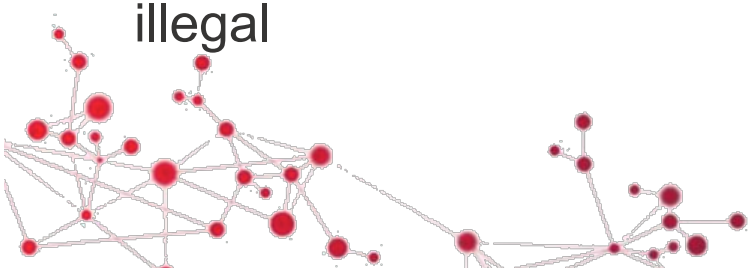
Recent News in this Area

Canada Revenue Agency

- Three year pilot/review
  - 424 businesses (restaurants in all provinces and grocery stores in Québec)
  - 143 cases of fraud
  - Average of $1 million for each case
  - CRA Finds Rampant Restaurant Fraud

Vancouver, British Columbia

- June 2012: InfoSpec Systems Inc. convicted of selling zapper software by the BC Supreme Court after a CRA investigation
- July 2013: British Columbia Court of Appeals acquitted the company due to the sale of zapper software not being illegal
- January 2014: Law went into effect that made it illegal



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States with Current Legislation

Many states have laws that makes it illegal to possess a zapper:

- Arkansas
- California
- Connecticut
- Georgia
- Illinois
- Indiana
- Kentucky
- Louisiana
- Maine
- Michigan
- North Carolina
- Oklahoma
- Tennessee
- Utah
- Vermont
- Washington
- West Virginia

Three additional states considered legislation this past year:

- Missouri
- New York
- Texas

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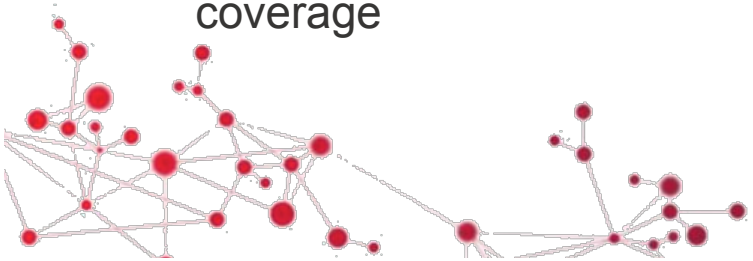
Options to Detect Sales Suppression Devices

- Set up fake stores and invite POS/ECR sales people (NY approach)
  - Client list from salespeople that offer zapper software
  - Targeted list but still need to perform audits on identified clients
- Make a number of purchases prior to conducting an audit
  - Time consuming and number of audits is limited based upon available resources
- Identify leads from other agency audits (Labor)
  - Employees being paid cash or unusual ratio of cash to credit
- Use a Sales Recording Module (Québec approach)
  - Automated and allows for resources to be designated to other audit functions
  - Pilot approach or full implementation
  - Reduces time and cost of audits allowing for stronger audit coverage



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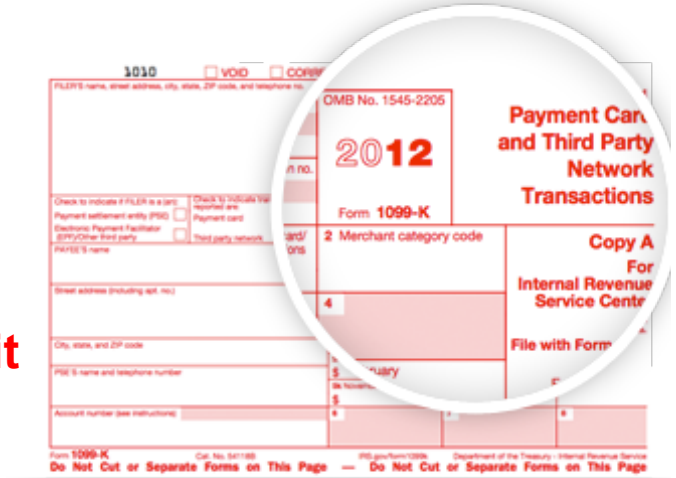
Additional Option to Detect Sales Suppression Devices

1099-K

- Current use of 1099-K data in audit selection
  - Manipulate the sales data based upon known issues (tips, sales tax, etc…)
  - Apply cash/credit industry averages to data
  - Compare amount to reported amount
  - Targeted list of audit candidates

- While this may help identify noncompliance issues, it will not resolve the skimming or zapper issues
  - Sales amount includes non-taxable goods, tax, tip, and shipping costs (cannot get exact)
  - Depending upon how the business is registered, it does not separate sales amounts by location
  - In-state vs out-of-state sales
  - Does not track cash
  - The timing of receiving the information
  - **Still have to take the time to perform the audit**



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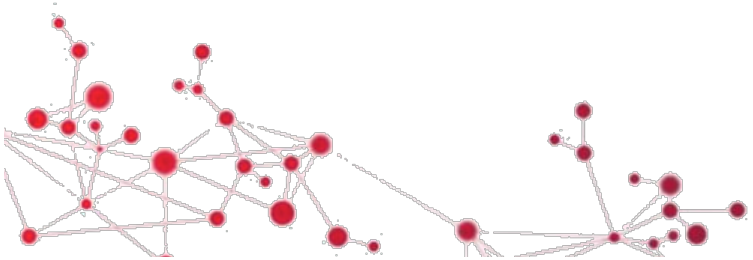
The Revenu Québec Solution

Québec determined that the solution needed to:

- Solve the problem of zappers **and** traditional skimming
- Be independent of Point-of-Sale (POS) system developers and Electronic Cash Register (ECR) manufacturers, as they believe that some were involved in the design and distribution of zapper software
  - New York findings support this
- Make restaurant owners aware of risk of being caught
- Securely send transactional information to the Tax Authority
- Promote voluntary compliance
- Not be intrusive for the business owner



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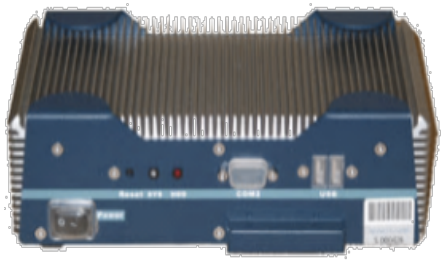
The Sales Recording Module (SRM)

The SRM is the device underlying the technological solution. The SRM must be connected to a cash register or point-of-sale system and a receipt printer.



SRM

It is designed to:

- Serve as an “electronic lockbox”
- Receive data related to commercial transactions
- Record transaction information (such as sales and tax amounts) in secure data storage
- Send the information required to print the bill to a receipt printer
- Be tamper resistant and allow for easy detection if tampering was attempted
- **Combat both zappers and more traditional skimming efforts**

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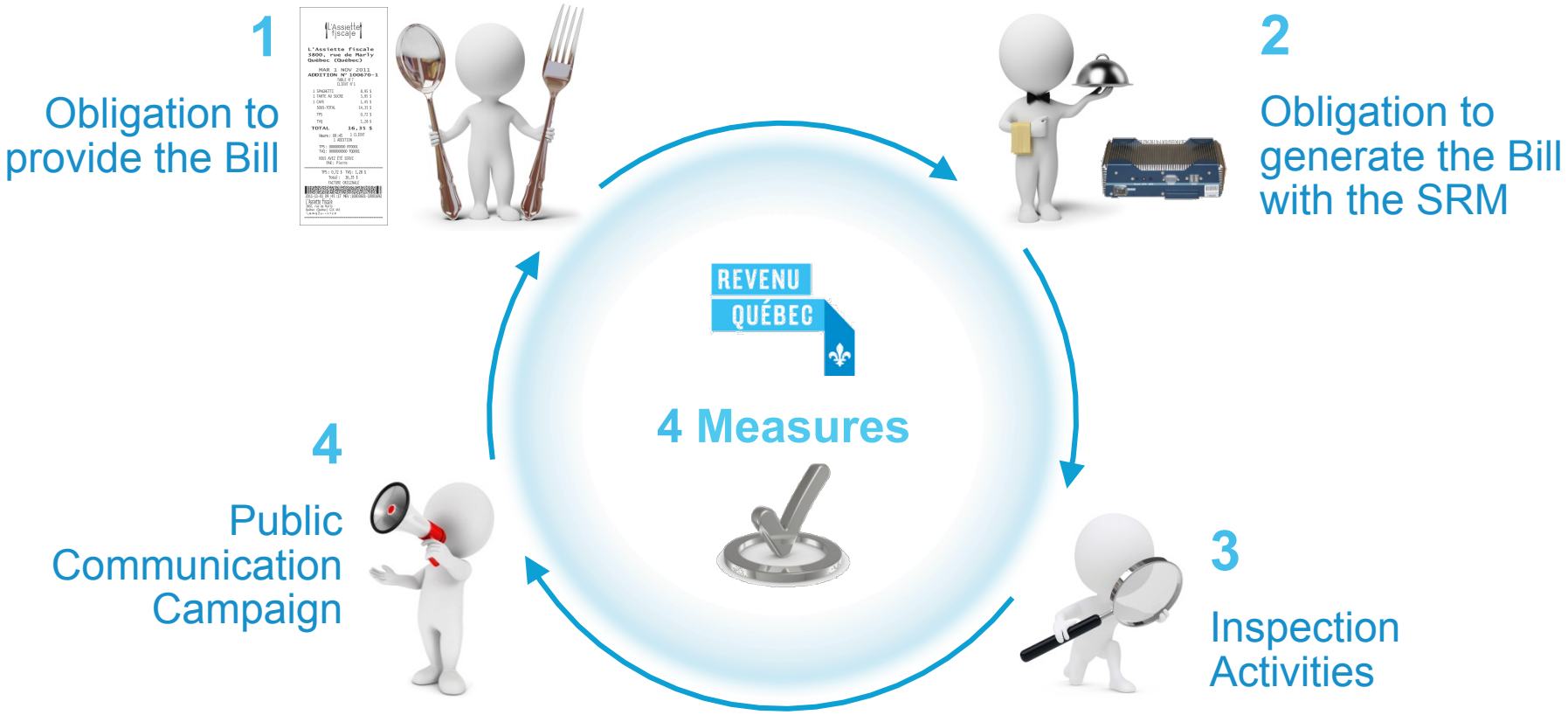
Mandatory Billing in the Restaurant Sector



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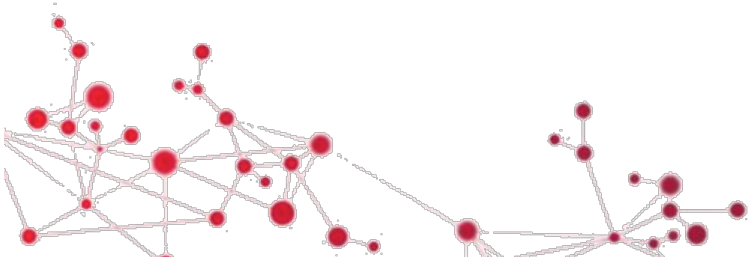
Flow of Data

POS System

Sales Recording Module

Receipt Printer

Cash Register



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Québec Results

- 2011-12, the Québec government recovered **$160 million** in additional sales tax **in the first year** alone
  - Does not include income tax or additional audit assessments
- By 2018-19, Québec estimates that they will have recovered $2.4 billion in additional consumption and income taxes

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Revenu Québec Results

- The cost to audit a restaurant has decreased from $4,400 to $190 (a 96% reduction)
- An audit that used to take 70 hours now takes only 3 hours
  - Benefits both the Revenue Department and the customer
- The number of annual audits has increased from 120 to 8,000 and most of the work can be done electronically with minimal disruption to the business

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Pilot Approach

- Utilize SRM under existing Audit authority
  - Install SRM during initial taxpayer visit and record the data for approximately six months
  - Most states believe that they have this right under their authority to conduct audits
- Audit selection criteria based on existing DOR tools
- Benefits of the Pilot approach
  - Low cost and risk
  - No new legislation needed (likely)
  - Benefits would far exceed costs (ROI of 3:1 during first year of Pilot)
  - Proves the magnitude of the problem and provide a concrete estimate
  - Could be used in multiple industries to provide the legislature with very strong data to determine next steps

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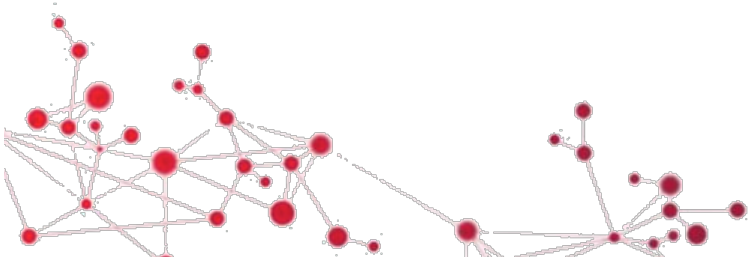
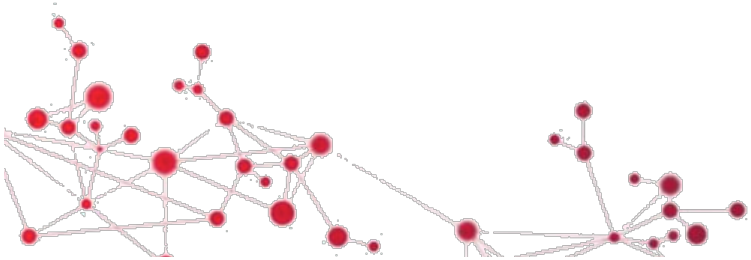
Full Implementation Approach

- An alternative approach would go straight to a full roll-out of the solution for one or more industries
- Each business would be required to use an SRM for each of their cash registers
- The state could then purchase inexpensive electronic cash registers for businesses with no electronic cash registers
- New legislation would likely be needed



Summary

- Traditional skimming has been around for years but technology has allowed skimming to become fast, easy, and extremely hard to detect
- Skimming and the use of zapper software has become the norm in cash based businesses
- Tax agencies are trying to combat technology with traditional audit techniques
- Successful IT solutions are available that combat both traditional skimming and sales suppression devices



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About the Presenter:

- Over 15 years of tax experience (13 in a tax agency)
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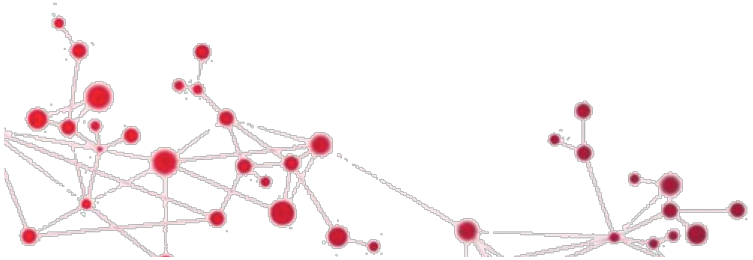
- Process improvement
- Team and agency-wide quality programs



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