Washington: Attorney General wins first-of-its-kind tax-zapping case

David M. Kall | Thursday, September 28, 2017

In recent years, it has not been easy for states to collect all the sales and use tax revenues they are entitled to. This is due, in part, to the difficulty they have had asserting authority over out-of-state Internet retailers, who are not subject to the same tax rules that in-state retailers are.

A lesser-publicized problem poses another mechanism through which tax dollars disappear. In 2012, the National Conference of State Legislatures (NCSL) issued an article warning that "[a]utomated sales suppression devices…have proliferated with the computerization of cash registers and have given retailers the ability to cheat state and local tax departments out of owed sales taxes through the falsification of electronic records of point of sale (POS) systems (modern cash registers)."

The article describes how it works: A suppression devices is stored on a portable USB drive that is then linked to a cash register system to modify sales records, ultimately to reflect fewer sales than actually occurred. For example, "a $5 receipt may become $4.50[,] or a $3 purchase may be erased altogether. For every dollar in sales a store deletes from its records, the owner gets to keep the extra cents that would otherwise be sent to a state and local government as sales tax."

The NCLS conceded the difficulty in quantifying the amount of losses. But a 2013 report that the Organisation for Economic Co-Operation and Development (OECD) issued, titled "Electronic Sales

Suppression: A Threat To Tax Revenues," declared that suppression devices, the most common of which are known as "Phantomware," and "Zappers," "result in massive tax loss globally," in the billions.

First criminal prosecution

On February 5, 2016, the Washington Attorney General announced that he was filing criminal charges against the owner of Facing East restaurant, Yu-Ling Wong, accusing her of "using 'sales suppression software' to hide cash transactions, [and] pocketing nearly $395,000 in sales tax collected from her patrons." The charge, the "first-of-its-kind criminal tax theft case," was for first degree theft, the standard sentence for which ranges from 43 to 57 months, with the possibility of the imposition of an additional 120 months for aggravating circumstances.

The announcement details how the fraud came to light:

> Facing East was selected for routine audit by the Department of Revenue to review the books from 2010 to 2013.
>
> DOR auditors are trained in sales suppression software and how to spot it. DOR staff noted a sudden change in cash receipts, which could be caused by such software, and found the data provided by Wong could not be relied upon to calculate sales tax owed.
>
> Based on the restaurant's previous receipts, which were more in line with industry standards, DOR staff estimated Wong owed in excess of $394,835.

On August 30, 2017, another press release from the Washington Attorney General revealed that Yu-Ling Wong had pled guilty. The court ordered her to pay $300,000 in restitution to the Department of Revenue, $600 in penalties and fees. In addition, the Department of Revenue will monitor the restaurateur and Facing East for five years.

Widespread criminal enterprises

In a follow up article, Bloomberg was able to put a number to the cost of tax suppression software in the United States, about $21 billion in 2009. The Washington case was especially significant because it "demonstrates how a single example of criminal tax fraud was used to reveal a much broader web of crime, potentially involving dozens of small businesses in multiple states." In a different, but related case, U.S. v. Yin, John Yin, a salesman for a Canadian company "sold tax zapping software to [Yu-Ling] Wong and other restaurant owners in Washington, Oregon, and California."

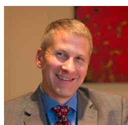
The restaurant industry is not the only one vulnerable to being zapped. Almost every "retail environment accepting cash payments, including bars, convenience stores, liquor stores, car washes, theaters, dry cleaners, and gas stations," is at risk, noted the Bloomberg follow up piece. What is more, "at least 30 percent of all electronic cash registers are running tax zapping software... Some estimates have asserted penetration rates of 50 percent or higher."

Another first in the Washington case involving the Facing East restaurant is the monitoring agreement. Yet a third Bloomberg article explains that although 27 states have anti-zapper statutes on the books, the Evergreen State is the only one that penalizes the wrongdoer with five-year monitoring. One Department of Revenue official cheered this step as being "really important because you can find someone, you can convict them, and they can just go back to what they were doing. But if you have a recording module—that gives you a sense of security that if someone wants to stay in business, they have to report correctly."

The Bloomberg follow-up article provides a list of states that have enacted anti-zapper legislation:

1. Alabama
2. Arkansas
3. California
4. Connecticut
5. Florida
6. Georgia
7. Illinois
8. Indiana
9. Kentucky
10. Louisiana
11. Maine
12. Michigan
13. Minnesota
14. North Carolina
15. North Dakota
16. Oklahoma
17. Pennsylvania
18. Rhode Island
19. South Dakota
20. Tennessee
21. Texas
22. Utah
23. Vermont
24. Virginia
25. Washington
26. West Virginia
27. Wyoming

The five states with the highest tax losses in 2009 were California, with $2.8 million; New York, with $1.8 million; Texas, with $1.6 million; and Illinois and Florida, which both had a little more than $1 million.



David M. Kall

Team member bio