



## Are Your Clients Zapping?

In December 2010, David Au pleaded guilty to defrauding the public of money in excess of \$5,000. He sold restaurant owners sales-deleting software (commonly called “zappers”), and helped them use it to delete their cash sales so they could evade paying federal and provincial income and sales taxes. The BC Supreme Court sentenced him to two years and six months in jail.

### Current penalties are high

Obviously, people use zappers to try to increase their personal wealth by lowering their tax costs. (If the users are renting real property on a percentage-rent basis, they will also save on rent.) But if your clients are using zappers, you should warn them of the risks. The penalties are heavy: gross negligence penalties under s. 163(2) of the *Income Tax Act (ITA)* are 50% of taxes falsely underpaid or that would have been falsely underpaid had the taxpayer succeeded in the attempt. For GST or HST, the gross negligence penalty under s. 285 of the *Excise Tax Act (ETA)* is 25% of the net tax under-reported. CRA may also prosecute these business owners for evasion, and proposed new *ITA* and *ETA* sections will add greatly to the penalties and criminal charges.

To help hide their deleted sales, businesses using zappers often pay some expenses with cash and don't take receipts. So if the CRA audits and finds the zapper software, and assesses higher income, these businesses won't be able to prove they had additional expenses to reduce that income. The result is a higher tax bill. And it will be very hard for you to recreate the expenses for CRA in a convincing way without receipts or other evidence of the expenses.

### It's just a matter of time before zappers are identified

The CRA has developed effective ways to prove your clients have been using zapper software. Bear in mind that even though some of the newer software is good enough to make it difficult for CRA to identify deleted sales, people make mistakes when using the software, and older versions weren't as well developed; they left multiple trails of deleted sales.

CRA auditors also have creative ways of finding zapper software. For example, CRA auditors might visit a restaurant a number of times (say 10 times) and purchase meals, saving the receipts. The auditor then checks the restaurant's records to see if all 10 purchases are recorded in the system.

### The law is cracking down on those who sell or use zappers

Although deleting sales and using zappers is illegal (tax evasion or fraud), in July 2013, the BC Court of Appeal *helped protect sellers* of zappers: *R. v. InfoSpec Systems Inc.*, 2013 BCCA 333 (CanLII). The company, InfoSpec Systems, made the popular “Profitek” cash register software. The Court said that InfoSpec was not guilty of a crime, despite selling zappers. The judges said that because “the law does not prohibit the making, possession, or sale of a zapper,” InfoSpec didn't commit fraud on the public by selling zappers. David Au, InfoSpec's salesman, had been convicted of fraud not because he *sold* the software but because he helped buyers *use* it.

However, despite the BC Court of Appeal decision, it is illegal in Quebec and Manitoba to use, make, sell, buy, or own zappers.

The federal government is now taking more specific action. [On October 22, 2013, the government introduced legislation](#) that will add new sections to the *ITA* and *ETA* to make zappers illegal starting January 1, 2014 (assuming the legislation is passed by then, which it is expected to be, as it is included in a Budget bill). The new sections will prohibit the use, purchase, possession, design, development, manufacture, possession for sale, offer for sale, sale, or any other supply of an “electronic suppression of sales device” (zappers). The law also applies to installation, upgrade, or maintenance contracts for zappers. The new *ITA* and *ETA* rules will be essentially identical to each other. (Evasion of GST/HST on cash sales can be a large part of the amount of tax evaded.) See proposed new *ITA* s. 163.3 and *ETA* s. 285.01 (the civil penalties) and *ITA* s. 239.1 and *ETA* s. 327.1 (the criminal rules).

### **Fines and possible jail time**

The first-time civil penalty for buying, owning, or using a zipper is \$5,000. For repeat offences, the penalty is \$50,000. (See proposed new *ITA* s. 163.3(2) and (3) and new *ETA* s. 285.01(2) and (3).) The penalty for *manufacture and sale* ranges from \$10,000 (for first-time offenders), \$50,000 (for those previously penalized for use or possession), to \$100,000 (for repeat sellers). (Keep in mind that your clients could also face gross negligence penalties for under-reporting income or GST/HST net tax.)

Furthermore, since the penalties apply under both the *ITA* and the *ETA*, they will in most cases be

double the amounts shown above — or triple if the province enacts parallel legislation. (Québec has already announced that it will do so, and the other provinces may well do so under their tax agreements with the federal government.) So the fixed penalty for simple possession of a zipper will in many cases be \$15,000.

The new *ITA* and *ETA* criminal law fines range from \$10,000 to \$500,000, plus imprisonment for two years, if the offences are prosecuted as “summary conviction” offences. More serious offences prosecuted by “indictment” are subject to penalties ranging from \$50,000 to \$1,000,000, plus imprisonment for up to five years.

The civil penalties don’t apply unless CRA assesses your clients before laying charges. (See proposed *ITA* s. 239.1(4) and *ETA* s. 327.1(4).) So, if your client is under criminal investigation and receives a notice of reassessment or a proposal letter from the CRA investigators, that letter can be a sign that charges are about to be laid.

### **Help your client voluntarily disclose**

So, what should you do if your client has used zippers? CRA has a “Voluntary Disclosure Program.” It lets you help your client correct prior tax filings without penalty or prosecution, if the client tells CRA the truth before a CRA auditor or other government agency contacts your client, his or her partners, or related corporations. The client must pay the taxes and interest, but the bill will be much cheaper and less painful than facing prosecution and having to pay the taxes and interest *plus* the fines, penalties, and legal fees.

### **Disclaimer:**

Readers should not rely on or use the information provided as a basis for a course of action without first obtaining the appropriate professional advice.