

Electronic Sales Suppression – Small Business Innovation Challenge

Seeking Expressions of Interest for the Following Eligible Stages:

- Phase 1: Feasibility Stage
- Phase 2: Product Development and Demonstration Stage

Problem Statement:

Recognizing the importance of a fair and competitive market and to ensure the integrity of the sales tax system, there is an identified need for a cost-effective, user-friendly and secure means of ensuring sales transactions are recorded and sales taxes are being remitted in line with tax obligations.

Outcomes and Considerations:

The solution should:

- create a verifiable, tamper-proof record of completed taxable transactions
- enable transaction records to be accessed easily for audit purposes and to identify sales suppression activities
- be fully automated, require no manual processing, and place minimal process burden on businesses
- protect consumer privacy
- be easy to integrate into existing and emerging sales platforms / systems including but not limited to POS, VPOS, ECR, e-commerce platform, and others
- address evolving payment and business models
- be scalable

Additional Considerations:

To encourage adoption the solution may include end-user benefits such as:

- decreased sales tax reporting effort by automating accounting and reporting requirements
- provide increased protection against employee related theft
- simple integration with existing business accounting software

Background and Rationale:

- The underground economy (UE) refers to economic activity that intentionally evades taxes that would normally accrue to government or public agencies. Sales suppression is an UE activity that refers to the deliberate and illegal practice of underreporting income, primarily to avoid the payment of taxes.
- One of the most effective business-to-consumer sales suppression tactics is electronic sales suppression (ESS), which involves the manipulation of point-of-sale (POS)/electronic cash register (ECR) systems. The ESS methods primarily used are as follows:
 - Programs stored within a POS/ECR system are known as phantom-ware;
 - Programs added on via a USB, CD or Internet link are known as zappers. Zappers are more difficult to detect due to the lack of integration with the businesses' operating system;
 - Sales suppression as a service where a salesman offers to erase, delete or destroy a merchants hard drive and replace it. Provided on demand in intervals and leaves merchant with audit proof deniability; and,
 - Abusing legitimate function on the POS/ECR system such as training mode.
- When businesses use sophisticated ESS methods, it creates an unfair advantage by allowing them to underreport business income, pay less tax to government, and retain the taxes paid by consumers.
- In addition to the impact of ESS on businesses that pay their fair share of taxes, this practice also reduces tax revenues that are used to fund essential government programs and services.
- In 2013 and 2017, the Organization for Economic Co-Operation and Development (OECD) released reports outlining the growing evidence of tax evasion in member countries and the various attempts made by tax authorities to address the issue.
- Tax authorities world-wide are implementing solutions to address activities that hide sales records and evade the payment of taxes that have been paid to business in good faith by consumers.
- In 2014, the federal government enacted an amendment to the federal *Income Tax Act* and the *Excise Tax Act* to make the use, possession and manufacturing of ESS software an offence. Changes to the *Criminal Code* also made the use, possession, acquisition, manufacture, development, sale, offer for sale or making available of ESS software a criminal offence in Canada.

- In 2015, Ontario amended the *Taxation Act, 2007* to make the use, possession and manufacturing of ESS software an offence punishable by fine, or imprisonment for the most serious activity.
- Addressing ESS can require additional measures beyond establishing the penalties already introduced by the federal and provincial governments. Improving detection and countermeasures, changing consumer culture by raising awareness of the impacts of sales suppression, and investing in sophisticated audit and enforcement resources are also required.

Additional Background:

Organisation for Economic Co-operation and Development (OECD): Technology Tools to Tackle Tax Evasion and Tax Fraud

This April 2017 report provides an overview of some of the technology tools that tax authorities have implemented to address tax evasion and tax fraud, focussing on electronic sales suppression and false invoicing. <http://www.oecd.org/tax/crime/technology-tools-to-tackle-tax-evasion-and-tax-fraud.htm>