Electronic Payments and Credit Card Chaos

Kansas

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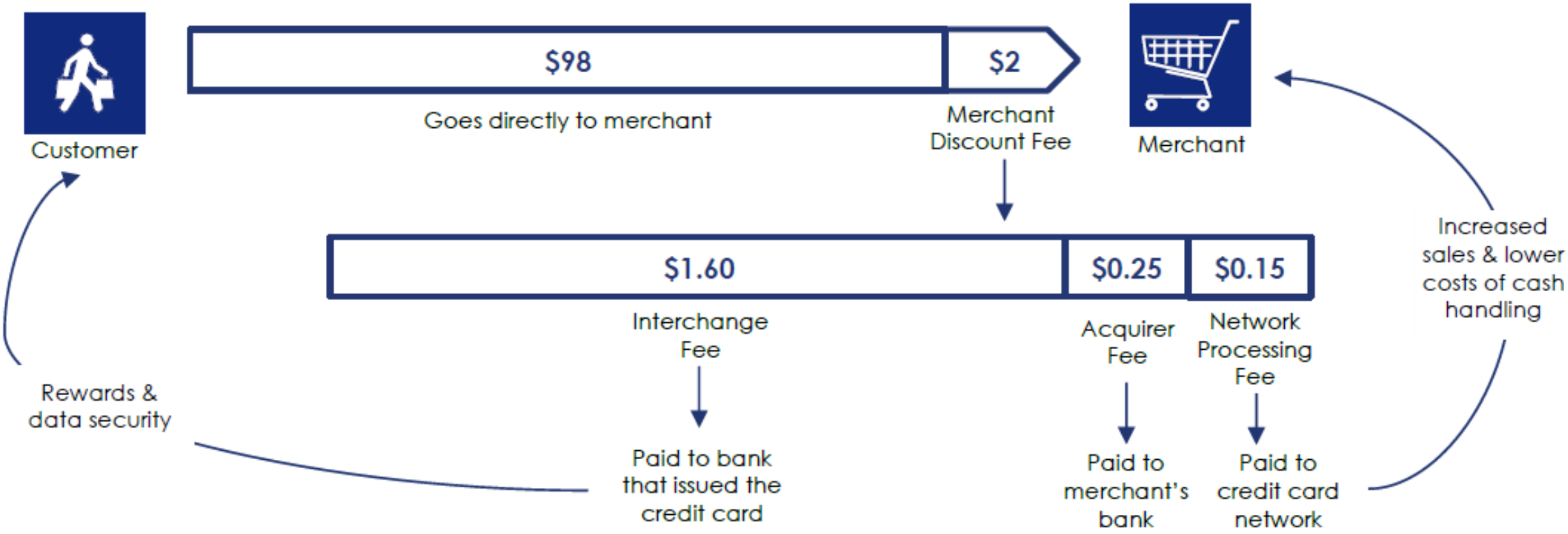
Breaking Down Interchange

Interchange is a fee for a valuable service that supports the ability of merchants to safely and securely complete sales with millions of customers. Interchange goes directly to card issuers (credit unions and banks).
Visa and Mastercard DO NOT receive Interchange.



Exempting Sales Tax from Interchange is Bad Policy

Interchange is a fee-for-service model

- Interchange fees are critical to the card payment processing system because they compensate issuers for the **costs and risk associated with providing and maintaining the cardholder's account and extending credit**.
- According to a 2022 Federal Reserve publication, **credit card program transactional costs have exceeded revenues from interchange since 2016**.
- A card issuer bears the **same credit and fraud risk from the tax and gratuity portions of a transaction** as it does for the other portions.

Merchant card processing costs compare favorably to other payment methods, including cash

Interchange fees are critical to the card payment processing system because they compensate issuers for the **costs and risk associated with providing and maintaining the cardholder's account and extending credit**.

Handling cash is not free. Research indicates that cash handling costs many retailers between 4.7 and 15.3%

Interchange rates have remained generally flat for the past decade

- Interchange is charged as a share of transaction value. Increases in total interchange revenue mean that consumers are simply choosing to use credit and debit cards as their preferred payment method more frequently.

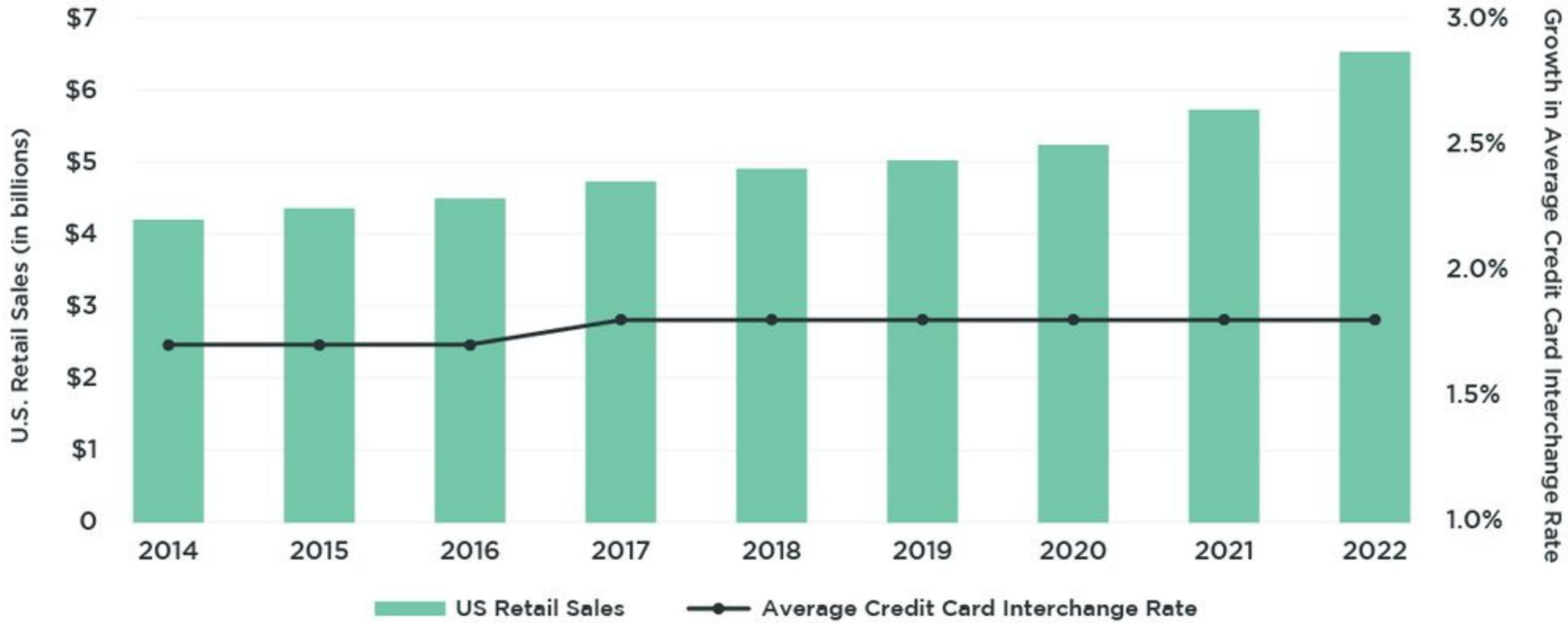
Exempting Sales Tax from Interchange is Bad Policy

Consumer Benefits				Merchant Benefits			Cost of Merchants	
Digital Access	Security & Fraud Protection	Access to Liquidity	Rewards/ Benefits	E-Commerce Digital Channels	Guaranteed payment	Higher Sales & Faster Checkout	Average Merchant Cost of a $100 Transaction	
✓	✓	✓	✓	✓	✓	✓	VISA	$1.43-$2.40
✓	✓	✓	✓	✓	✓	✓	AMERICAN EXPRESS	$2.50-$3.50
✓			✓	✓	✓	✓	PayPal	$3.20-$4.40
✓			✓	✓	✓	✓	amazon pay	$3.20-$3.90
✓	✓		✓	✓	✓	✓	Pay	$1.43-$3.50
✓		✓		✓	✓		afterpay	$4.21-$6.00
✓		✓		✓	✓		Klarna.	$3.59-$5.99
					✓		CASH: FOOD/ GROCERY	$4.70
					✓		CASH: CONVENIENCE/ GAS	$8.30
					✓		CASH: AVERAGE ACROSS ALL SEGMENTS[1]	$9.10

Note: Apple pay merchant costs are calculated assuming users access the service with either a Visa, Mastercard or Amex branded card. Assuming this, merchants are liable to a cost range between the lowest and highest estimated charge of the three networks

[1] IHL Group: Cash Multipliers – How reducing the costs of cash handling can enable r etail sales and profit growth (January 8, 2018) https://www.ihlservices.com/product/costofcash/

Interchange rates have remained generally flat while sales are growing



Exempting sales tax from interchange shifts an expense from retailers who already have ways to recoup remittance costs. The expense is shifted to financial institutions, small businesses and consumers

KS Small Business Example		
Annual Revenue		$1 Million
Sales Tax Collected: 8.65%* (blended average state + local tax)	0.0865	$86.5K
Sales via Credit Card or Debit Card		
- Credit Card**	43%	$430K
- Debit Card**	23%	$230K
Sales Tax from Credit Card sales		$37.2K
Sales Tax from Debit Card sales		$19.9K
Average Credit Interchange:	2.30%	$856
Average Debit Interchange:	0.40%	$80
Interchange on Sales Tax from credit & debit sales per year		$935
Monthly "Savings" from Exemption Legislation		**$78**

KS Home Depot Example		
# of Stores in Kansas***		16
Annual Revenue Per Store (pre-sales tax)***		$69.3 Million
Gross Revenue (Sales + Sales Tax)		$1.205 Billion
Sales Tax Collected: 8.65% (blended average state + local tax)	0.0865	$104.2 Million
Sales via Credit or Debit Card		
- Credit Card**	43%	$477 Million
- Debit Card**	23%	$255.1 Million
Sales Tax from Credit Card sales		$41.2 Million
Sales Tax from Debit Card sales		$22 Million
Average Credit Interchange:	2.30%	$949K
Average Debit Interchange:	0.40%	$88K
Interchange on Sales Tax from credit and debit sales per year		$1.03 Million
Monthly "Savings" from Exemption Legislation		**$86.4K**

- A KS small business with $1 million in taxable annual sales will reduce its interchange expense by ~$935/ yr. Home Depot will reduce its interchange expense in KS by ~$1.03 million / yr.
- 30 states allow retailers to retain a small portion of sales tax for timely payment. (KS' is limited to retailers from 3 surrounding states)
- Interchange expense is tax deductible, retailers can surcharge for credit card transactions, and have a 30-day float to hold onto sales tax.
- Card issuers assume 100% of default risk. If customer defaults, card issuers absorb loss; we don't ask retailer for money back. Interchange supports operation of global payments network, funds rewards, and the transfer of risk from retailer to card issuer.
- Costs will be borne by consumers and small businesses in the form of higher fees, higher interest, operational complexities, and/or fewer rewards. Bill creates no discernable "savings" other than to big box retailers.

* Source: Tax Foundation ** Source: Visa Payment Panel *** Source: Home Depot Investor Relations site, 2Q 2024 earnings report ($660.17 sales per sq. ft, average store 105,000 sq. ft)

Tipped transactions are processed quickly, efficiently, and securely. That model should not be upended

Current System

Bill presented to customer

$100 food, $10 tax, $110 subtotal

Debit or Credit Card

Card given to server

Card authorized for bill amount + estimated tip (e.g. 20%)

$100 food, $10 tax $20 tip, $130 total

Bill & card returned to customer, customer adds tip and signs receipt

$100 food, $10 tax, $15 tip, $125 total

Server finalizes transaction for $125

Final amount ($125) is sent to payment network / issuer

Government(s) receive $10
Server receives $15
Card Processing Fee $2.88
Restaurant nets $97.12

Customer owes issuer $125 and may earn rewards (points, miles, cash back) on the entire $125

Current Benefits

- Accounts settle daily
- Customers tip more when using credit cards
- Lower risk of theft / unreported income
- Faster, more convenient check out process
- Card issuer assumes 100% of default risk
- Customers earn rewards on entire transaction

- In this example, exempting tax & tip from interchange would "save" the restaurant $0.58 (2.3% of $25) but could result in tax & tip getting paid in cash if issuers refuse to process part of transaction for free
- There's a much higher risk of fraud if a restaurant over-reports tips and under-reports food and beverage sales to avoid interchange. No way to audit.
- Increased use of cash = lower tips, more theft, reduced government revenue (undeclared income), customer inconvenience and dissatisfaction, merchant incurs higher cash handling expenses, which can reach 15.5% for bars and restaurants*

*Source: Small Business & Entrepreneurship Council, IHL Group Report

Restaurants want the Government to intervene and simply lower an expense they don't like paying

Restaurant's Claim: "We shouldn't pay interchange on money we hand over to someone else." By that logic, they shouldn't pay interchange on almost everything

Transaction Example

$75 Food and Beverage
$15 Tip
$10 Tax
$100 Total

$2 - Interchange

Money they hand over to someone else

Tip to server

Sales Tax to State / Local Government

Payroll Tax to Federal Government

Wages & benefits to employees (reduced hourly wage to servers, higher wages to non-tipped staff)

Rent or Mortgage to landlord / mortgage holder

Utility expenses

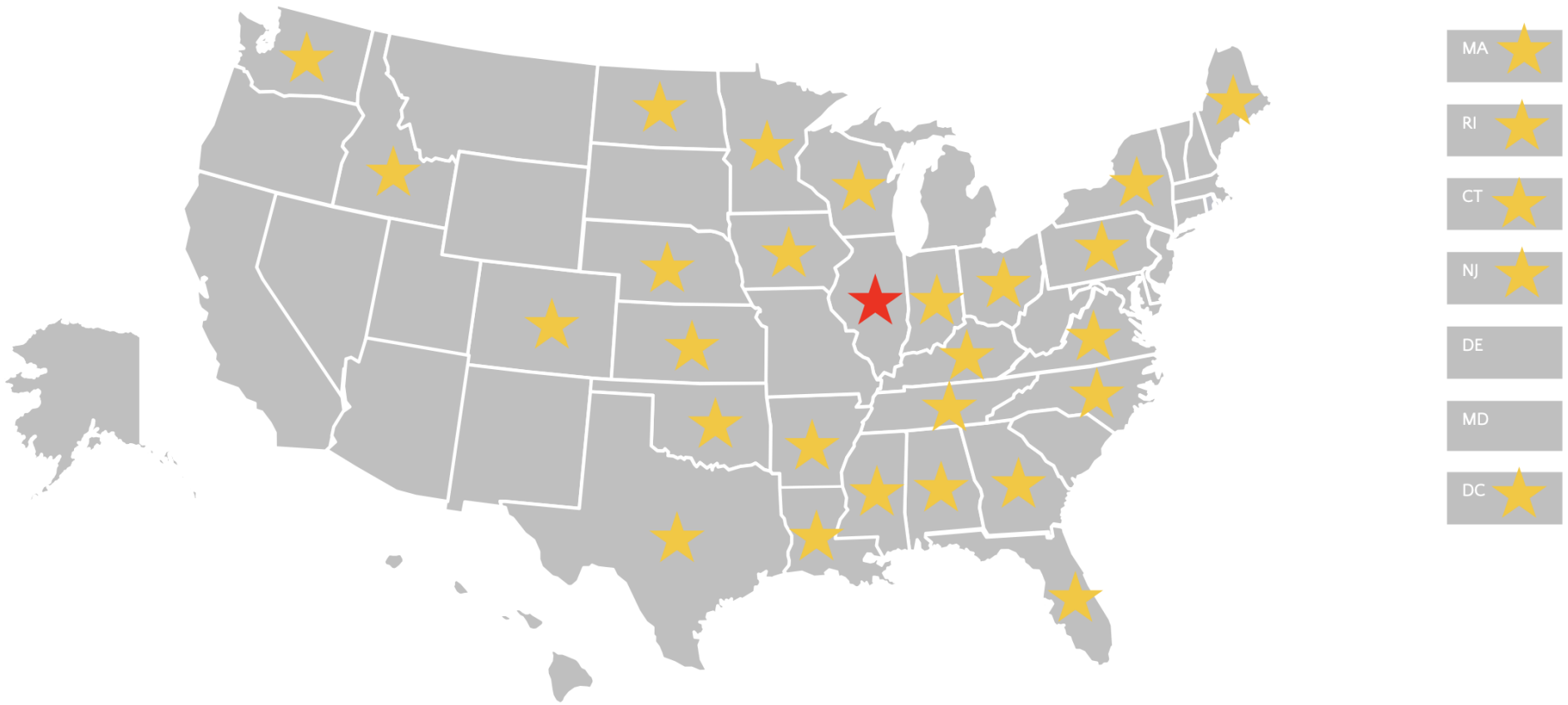
Insurance premiums

Food, beverage and equipment suppliers

"Sales tax and tips are different" doesn't pass muster. The card issuer is floating the entire transaction amount regardless of where / how the restaurant allocates it

This idea has never become law as stand-alone legislation or in an open and transparent process

States where interchange legislation has failed since 2006: over 60 versions in 31 states



★ **Only time this was signed into law (7/1/25 effective date) was when it was inserted into a 1,275-page revenue bill as part of an end of session budget deal made without key stakeholders or legislative process and deliberation. A Federal lawsuit challenging the law is pending.**

A Federal Court has already limited the enforcement of Illinois' law

- On December 20, 2024, a federal district court granted a partial preliminary injunction against the Illinois Interchange Fee Prohibition Act (IFPA). The court found Illinois bankers and fellow plaintiffs are likely to prevail on the merits of their claim that the IFPA violates the federal rights of national banks and is preempted by the National Bank Act (NBA).

- This means the IFPA and similar bills, if passed, might apply only to credit unions and state chartered financial institutions. This could put community banks and credit unions at a competitive disadvantage to national players and potentially drive them to try and obtain federal charters in order to receive equal treatment.

- The Office of the Comptroller of the Currency (OCC), the federal regulator tasked with ensuring the safety and soundness of national banks, filed an amicus brief opposing the IFPA and called it "ill-conceived, highly unusual, and largely unworkable." The OCC wrote, "If the IFPA is allowed to remain in effect, it is likely that fraud risk would increase significantly, consumers services would be constrained, and public trust would decline," and, if other states copied Illinois, it would create "a fractured, highly inefficient, and unworkable payment system that would materially affect interstate commerce."

- No other jurisdiction on the planet calculates debit and credit card transactions in the manner prescribed by the IFPA and similar bills.

- The next hearing on the case is on February 4, 2025.

No other state should take up this issue, particularly while Federal litigation is pending

Exempting TPT from Interchange Would Create Operational Chaos

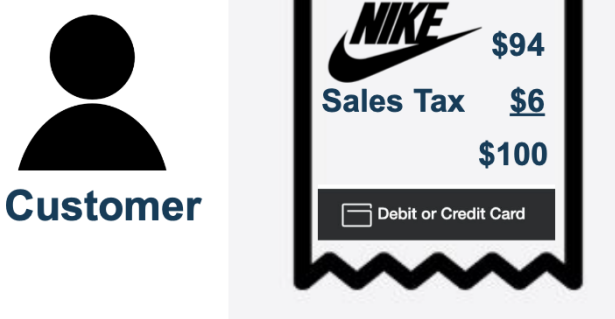
Significant changes required for merchant systems and payments infrastructure supporting credit and debit cards

- **Merchant acquirers, payment networks and card issuers would require technology changes** while simultaneously being forced to accept reduced interchange revenue.
- All card networks would need to update system specifications including processing specifications, message formats, analytical and accounting calculation systems, and then publish them. Then connected upstream (**card issuers, card processors**) and downstream (**gateways, third party processors, payment processors, terminal software developers, point-of-sale system vendors**) participants would **ALL** require system changes.
- Similar system overhauls have taken **many years** to implement and required billions in investment by issuers, acquirers, payment networks, and merchants.
- Most - if not all - point-of-sale software (and some hardware) used by **merchants** to process transactions will **require updates** (often at the expense of the merchant).

Tax compliance, recordkeeping and audit would be operational hurdles

Exempting TPT from interchange creates confusion, inconvenience and costs for customers and small businesses, and only benefits big box retailers

Current System



$100

- Govt. gets $6 in taxes
- Retailer pays $2.30 in fees, **nets $91.70**

Proposed System

$100

$94

- Retailer pays $2.16 in fees, **nets $91.84**

$6

- Govt. gets $6 in taxes
- Card is run twice and financial institutions process sales tax for free, **OR**
- Financial institutions won't process sales tax for free. Tax is paid by cash or check

Customer may have to conduct two transactions, creating confusion and frustration. Retailer pockets additional $0.14, but that does not include their compliance costs. No savings to customer, no benefit to State. State will incur compliance costs too.

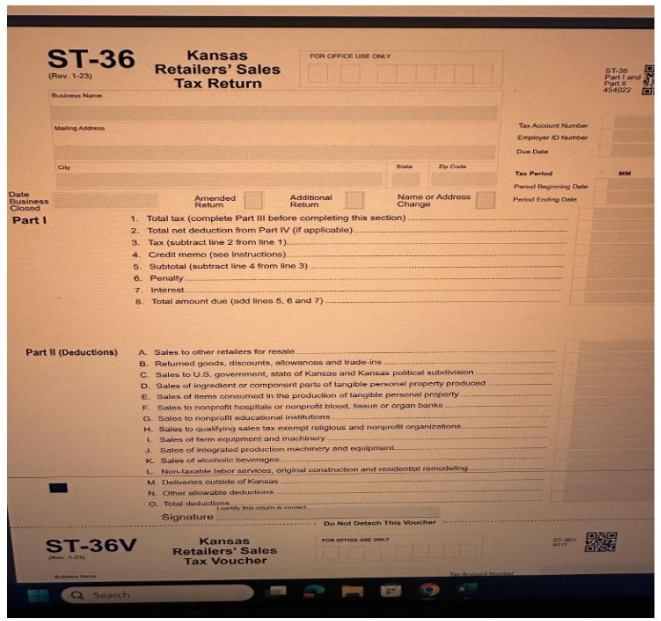
Submitting “tax documentation within 180 days” does nothing to make the policy feasible. Issuers would still need specific tax data on every unique transaction

38,000 Retailers in KS*

9,300 Banks & Credit Unions in US*

Billions of transactions per year

KS-Sales Tax Form ST36



- KS Sales Tax Form ST36 only captures total taxable and non-taxable sales, deductions, and tax due. It doesn’t break out cash vs. credit vs. debit sales and provides no individualized transaction level data.
- Since the legislation holds card issuers responsible for “crediting back interchange fees charged on the tax,” this impacts all 4,500 banks and 4,800 credit unions in the US, every time one of their debit or credit cards is used in Kansas.
- Several billion credit and debit card transactions are processed in KS every year. Each issuer would need tax information from the retailer on each transaction on their customer’s cards to calculate the refund. Aggregate data from tax returns is useless.

* Source: National Retail Federation, American Bankers Association, National Credit Union Association

Retailers are conflating fixed vs. variable costs and percentages vs. dollars

Retailer Claim: "My credit card fees are higher than my rent/mortgage"

Rent/Mortgage:
Fixed Cost

Same monthly amount, regardless of sales

Example:
$15,000 / month, regardless of sales

Credit Card Fees:
Variable Cost

Different monthly amount, based on sales

Example:
~$25 month =
~$1,000 in credit card sales

~$15,000 month =
~$600K in credit card sales

~$75,000 month =
~$3MM in credit card sales

Would you rather have $1,000 in monthly credit card sales (card fees much lower than rent) or $3,000,000 in monthly credit card sales (card fees much higher than rent)?

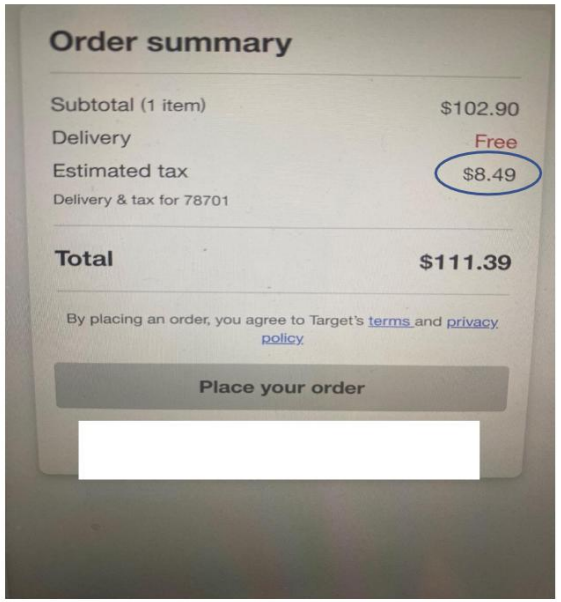
Retailer Claim: "My credit card processing fees have increased from $50,000 to $100,000 in the last 2 years"

- When retailers make this claim they will most likely quote a dollar figure, not a percent
- Credit card processing fees as a dollar figure have increased because sales have increased
- Credit card processing fees as a percent of sale are flat, negotiable, and competitive
- State and local sales tax revenue has increased, especially during and after the pandemic
- This is due to increased customer spending, not an increase in the sales tax rate

When a retailer complains about increased credit card processing fees, they are complaining about an expense directly attributable to increased sales. Why would increased sales require government intervention?

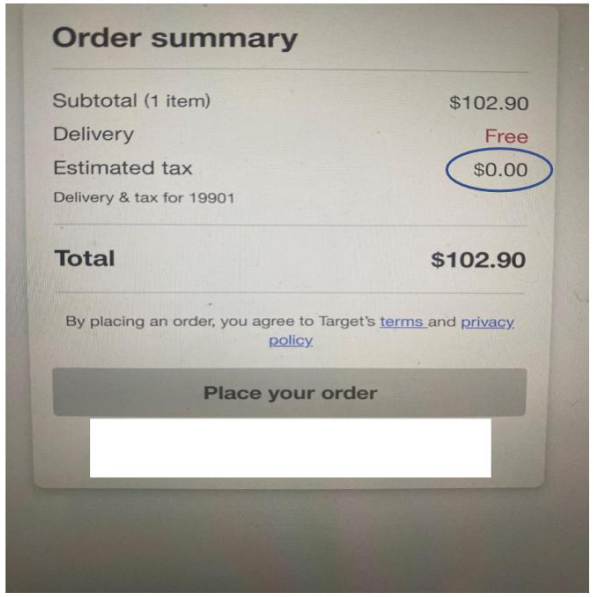
Retailers already pay no interchange on sales tax in the 5 states that have no sales tax, yet merchandise is the same price. No savings are passed along to the customer

State with Sales Tax



Merchandise Price = $102.90

State without Sales Tax



No interchange on sales tax because there is no sales tax

- New Hampshire, Oregon, Montana, Alaska, and Delaware (NOMAD states) have no sales tax. Retailers pay no interchange on sales tax because there is no sales tax.
- If exempting sales tax from interchange results in savings to customers as bill proponents claim, then merchandise should already be cheaper in the NOMAD states. It is not.
- In the example above from a major retailer website, the merchandise price is exactly the same, regardless of whether it is shipping to a state with sales tax or without sales tax.
- This bill is simply a giveaway to big box retailers who can already hold back a portion of sales tax. They can also surcharge for using credit cards. Additionally, interchange on the total transaction amount, not only the sales tax, is already tax deductible to them.

Thank You!

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