

AN INAPPROPRIATE COST OF DOING BUSINESS: PAYING THE INTERCHANGE FEE ON SALES TAX FOR CREDIT CARD PURCHASES

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CREDIT CARDS PROVIDE A CONVENIENCE FOR CONSUMERS AND MERCHANTS WHEN SHOPPING, BOTH IN-PERSON OR ONLINE. This convenience comes at a cost for merchants since credit card companies charge them an interchange fee (or “swipe fee”) on each credit card purchase. Throughout the last decade, credit card utilization and popularity have increased drastically for brick-and-mortar businesses and e-commerce businesses. As of 2021, there were 196 million credit card users in the United States.¹

Merchants pay fees on the purchase price of items sold, and they also pay fees on the sales tax charged on the purchase. Sales tax rates are set at the state level (six percent) and can be increased beyond the state level by county governments. Currently, not paying the interchange fees is not an option for credit card purchases. This means a merchant is responsible for the fees associated with the purchases, whether it benefits the merchant or the state. While these merchants are simply collecting the sales tax from customers on behalf of the state, the merchant is burdened with paying the interchange fee for every taxable transaction processed.² Charging credit card swipe fees on the sales tax collected by the merchant continues to be a point of contention between merchants, credit card companies, and the state of Florida.

WHAT ARE INTERCHANGE FEES?

Interchange fees are charges that merchants are required to pay the processing company when a credit or debit card is used to pay for transactions. This interchange fee is in addition to the rental and network connection costs associated with these payments. These fees are set by the card processors (e.g., VISA, MasterCard, etc.), and merchants are charged these fees every time a card is used in a transaction.³ The transaction is run through a

network to process the payment, and each payment run over the network is charged an interchange fee that the merchant is responsible for paying. In addition to the price and interchange fees on the items sold, merchants also pay the interchange fees on the sales tax portion of the transaction. These fees end up costing merchants millions of dollars, and the trend is that it will continue to rise, due to an increasing amount of credit and debit card transactions occurring as opposed to other payment methods, such as cash or check.⁴ While the interchange fees associated with each individual sales transaction may be small, a merchant with hundreds of daily transactions can quickly accumulate a large fee.⁵

SALES TAX IMPLICATIONS

From a merchant’s perspective, there are two components to every taxable transaction – one that benefits the merchant and one that satisfies sales tax collection requirements. The first component is where the customer purchases the items, and the second is when the sales tax is added to the total amount due from the customer. While it appears to be a single transaction, each component is charged an interchange fee.⁶ The merchant and the state or local government are two different beneficiaries of this same transaction. The first beneficiary is the merchant selling these items. The entire sales tax amount is collected by the merchant and remitted to the state, which is the second beneficiary of the transaction. As shown in Figure 1, two components of the sale result in two different beneficiaries.

The current process, as shown in Figure 1, has merchants paying the interchange fees on both the sale of the goods and on the sales tax when a credit card is used to complete a transaction. The merchants act as intermediary in the second component of the

¹ Becky Pokora, Forbes, “9 Interesting Credit Card Statistics,” retrieved from <https://www.forbes.com/advisor/credit-cards/credit-card-statistics/>, accessed on January 31, 2023.

² National Bureau of Economic Research, “From Transactions Data to Economic Statistics: Constructing Real-Time, High-Frequency, Geographic Measures of Consumer Spending,” retrieved from <http://www.nber.org/papers/w26253>, accessed on January 31, 2023.

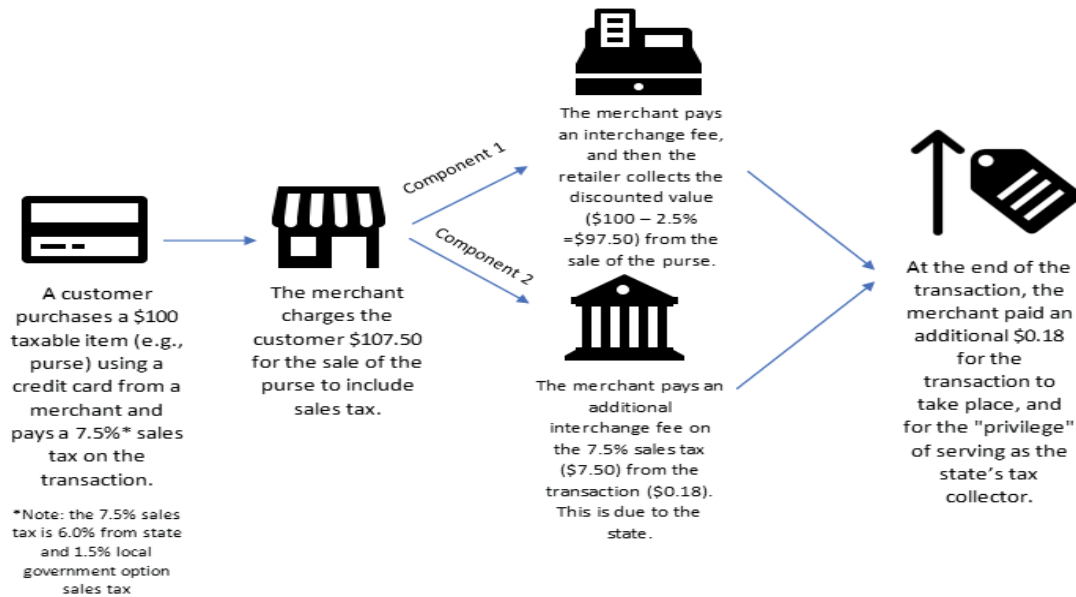
³ Food Marketing Institute, “Food Marketing Institute Debit Card Swipe Fee Litigation Backgrounder,” November 2011.

⁴ Forbes Advisor, “Credit Card Processing Fees (2023 Guide),” retrieved from <https://www.forbes.com/advisor/business/credit-card-processing-fees/>, accessed on January 31, 2023.

⁵ Example: A merchant does 5,000 credit card transactions daily with an average of \$50 per transaction (5,000 X \$50 = \$250,000). Assuming a state/local sales tax rate of 7.5 percent, the merchant charges customers \$267,500 (\$250,000 X 1.075). The merchant pays an interchange fee (2.5 percent) and collects \$243,750 from the sales. The merchant also pays an interchange fee (2.5 percent) on the \$17,500 collected in sales tax: \$17,500 X 0.025 = \$437.50. Over the course of a year, this totals more than \$159,000 (\$437.50/day X 365 days = \$159,687.50).

⁶ Forbes Advisor, “Credit Card Processing Fees (2023 Guide),” retrieved from <https://www.forbes.com/advisor/business/credit-card-processing-fees/>, accessed on January 31, 2023.

Figure 1: Sales Tax Swipe Transaction Fee Example



Source: Forbes Advisor, "Credit Card Processing Fees (2023 Guide)."

transaction, which occurs between the consumer and the state. Although the consumer is using the convenience of their credit card to purchase an item from the merchant, the merchants are responsible for paying the interchange fee for the sales tax part of the transaction instead of the customer paying for this fee. The merchant, however, only benefits directly from the sale of goods and receives nothing from the sales tax component.

Most major credit card companies charge interchange fees between 1.5 to 3.5 percent, costing merchants around 17 cents to 35 cents per credit or debit card transaction. While the interchange fee on the sales tax seems minor, it adds up over the course of thousands of transactions Florida merchants process during the year.^{7,8} When one parses out the transaction, one finds that merchants pay interchange fees twice for a single credit card transaction and only obtain the benefit for selling goods or services. The cost of doing business with credit cards becomes cumbersome for merchants as they try to avoid adding fees for the customer but also to avoid paying extra fees for components that do not directly benefit their business revenue.

OPTIONS

In addition to maintaining the status quo, Florida TaxWatch has identified three options that warrant consideration, as shown in Figure 2.⁹

Option 1: State Reimburses Swipe Fee – The interchange fee would be charged on both the sales component and on the sales tax component of the transaction, as is the current practice; however, the state would reimburse merchants the interchange fee charged on the sales tax component of the transaction.

Option 2: Customer Covers the Swipe Fee – The interchange fee would be charged on both the sales component and on the sales tax component of the transaction; however, the merchant would only be required to pay the interchange fee on the sales component of the transaction. The customer would be responsible for paying the interchange fee on the sales tax component of the transaction.

Option 3: Excluding the Swipe Fee – The interchange fee would be charged only on the sales component of the transaction; however, neither the merchant nor the customer would pay the interchange fee for the sales tax component of the transaction.

Under Option 1, the credit card company and the merchant would essentially be held harmless for the interchange fees on the sales tax component of the transaction. After paying the credit card processor both interchange fees, the merchant would then be reimbursed for the interchange fees on the sales tax component of the transaction by the state. Under this option, the state would absorb the costs of the interchange fees on the sales tax component of the transaction. This could be viewed as a cost of doing business or payment to the states for the merchant collecting and remitting sales tax to the state. Further analysis is required to better understand the fiscal

⁷ Food Marketing Institute (n 5).

⁸ Board of Governors of the Federal Reserve System, "Commercial Automated Clearinghouse Transactions Processed by the Federal Reserve," June 2022. Note: In 2021, an average of 71 million transactions occurred in one day. Multiplying the average number of transactions by the average interchange fee for sales tax transactions only, equates to \$18,460,000 that merchants are paying for collecting the sales tax on behalf of the state.

⁹ United States Government Accountability Office, "Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges," November 2009.

impacts to the state.

Figure 2: Options and Outcomes

	<u>Status Quo</u>	<u>#1: Swipe Fee is Reimbursed by the State</u>	<u>#2: Customer Covers Interchange Fee</u>	<u>#3: Excluding the Interchange Fee</u>
Suggested Action:	No change in the situation and merchants continue to pay to collect sales tax on transactions.	Allow the interchange fee to be charged on both the sale of the goods or services being purchased and on the sales tax portion of the transaction. Then, the state or local government reimburses the merchant for all interchange fees charged from sales tax portion of the transaction.	Allow merchants to charge the interchange fees for the sales tax component of the transaction to the customer.	Exclude interchange fees from the sales tax component of the transaction and only charge interchange fees to the amount due for the goods or services sold.
Sensible Outcome:	Merchants would continue to shift to incentivizing cash or check discounts and payment by credit card would become less popular in stores which could have major economic impacts.	Merchants would be reimbursed for the money they pay to collect sales tax on credit card transactions and would at worst, "break-even" on the sales processed using credit cards.	Merchants would no longer be paying the interchange fee; however, the cost of the interchange fee shifts from the merchant to the consumer to pay interchange fees for the sales tax component of the transaction.	Merchants would no longer be charged a swipe fee on a component of the sale that does not contribute to the merchant's revenue and the cost would not transfer to the consumer.

Source: U.S. Government Accounting Office (2009)

Under Option 2, the merchant would either charge the customer for the interchange fee on the sales tax portion of the transaction and then pay both interchange fees to the credit card processor, or the credit card processor would aggregate the customer's interchange fees and include that amount on the customer's monthly credit card statement. This would likely require considerable software and technology revisions to the credit card processing network, as well as to the accounting practices of the merchant and the credit card company.

Under Option 3, the costs of the interchange fees on the sales tax component of the transaction would be absorbed by the credit card company. Neither the merchant nor the consumer would be responsible for paying this interchange fee. Two identical bills (Senate Bill 574 and House Bill 677) to be considered by the 2023 Florida legislature would, if enacted into law, exclude the amount of sales tax listed separately on the sales slip from the amount on which the interchange fee is charged for the electronic payment transaction. The credit card processor would then have the option of either deducting the amount of tax imposed from the calculation of interchange fees or rebating an amount of interchange fees proportionate to the amount attributable to the tax. Similar legislation is under consideration by other states. Wisconsin and Idaho, for example, are considering legislation that would ban the imposition of an interchange fee on the sales tax portion of transaction when accepting credit card payments from customers.

CONCLUSIONS

There was a time when everyone paid for everyday purchases with either cash or a check. Credit card


purchases were generally reserved for large, infrequent, or emergency purchases. Today, credit cards are accepted virtually everywhere and greatly expand consumer purchasing power worldwide. While credit and debit card purchases are convenient and secure, paying the interchange fees on the sales tax component of the transaction remains an issue for merchants and credit card companies.

The process for paying interchange fees to the credit card processors and collecting and remitting sales tax to the state is complex. In addition, there are other taxable situations that may need to be looked at to address sales and excise tax issues in the future. For example, consider merchants that sell motor fuels at the pump. The sales tax is incurred at the point of transfer to the merchant, not at the point of sale. Also, when a restaurant patron leaves a cash tip on the table, there is no interchange fee, and the employee can simply collect the tip. If, however, the patron includes the tip on a credit card, the restaurant owner (employer) is responsible for paying the interchange fee on the sales component of the transaction and for reimbursing the employee the full amount of the tip specified on the credit card receipt.


Florida's Department of Revenue relies heavily on Florida merchants to collect and remit sales tax, including sales tax from credit and debit card transactions to the state. As such, Florida TaxWatch does not find it fair to penalize Florida merchants for doing something that the state needs them to do. Florida TaxWatch supports efforts by the Florida legislature to exclude the amount of sales tax listed separately on the sales slip from the amount on which the interchange fee is charged for electronic payment transactions.



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