

Department of Finance and Administration

Legislative Impact Statement

Bill: SB1185

Bill Subtitle: TO ALLOW TAXPAYERS TO DEDUCT CREDIT CARD INTERCHANGE FEES CHARGED ON CERTAIN SALES AND USE TAXES COLLECTED AND REMITTED TO THE STATE.

Basic Change :

Senator D. Sanders

The proposal allows a taxpayer to claim a sales tax credit for interchange fees charged by a credit card processor on a portion of the state sales tax collected from the consumer when the consumer used a credit or debit card to pay for the merchandise. The tax credit is limited to the portion of the interchange fees billed by the credit card processor to the retailer on the 5.875% portion of the 6.5% state sales tax. For sales of food, the interchange fee tax credit would be allowed for fees on the 1.375% portion of the total 1.5% tax. No tax credit against the tax due would be allowed for credit card interchange fees billed on the remaining portions of the state sales tax or on local sales taxes. The bill provides for tax credit eligibility for in-state sellers only and would not be provided to out-of-state sellers collecting Arkansas Compensating Use Taxes.

When preparing their monthly tax reports, taxpayers would calculate the amount of credit by determining the amount of interchange fees they incurred on the eligible portion of their state sales tax collections. Taxpayers would then claim the tax credit against the tax due reflected on the form. The proposal would be effective 90 days after final adjournment of the 89th General Assembly.

Revenue Impact :

FY14 Tax Decrease

Total Impact to State Revenues **- \$18.52 million**

-\$13.72 million --- State General Revenue (4.5%)
-\$ 2.67 million --- Educational Adequacy (.875% tax)
-\$ 1.52 million --- Property Tax Relief Trust Fund (.5%)
-\$ 0 --- Conservation Tax (.125%)
-\$ 0 --- Highway Fund (.5%)
-\$ 0 --- Educational Excellence Trust Fund
-\$ 0 --- Educational Adequacy (GR transfer)
-\$.43 million --- State Central Services
-\$.19 million --- Constitutional Officers

FY15 Tax Decrease

Total Impact to State Revenues **- \$19.28 million**

-\$12.17 million --- State General Revenue (4.5%)
-\$ 2.78 million --- Educational Adequacy (.875% tax)
-\$ 1.59 million --- Property Tax Relief Trust Fund (.5%)
-\$ 0 --- Conservation Tax (.125%)
-\$ 0 --- Highway Fund (.5%)
-\$ 1.94 million --- Educational Excellence Trust Fund
-\$.17 million --- Educational Adequacy (GR transfer)
-\$.44 million --- State Central Services
-\$.19 million --- Constitutional Officers

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Taxpayer Impact :

Taxpayers would be required to calculate the tax credit for the interchange fees paid on the eligible portion of their state sales tax collections. Sellers with credit card transactions with the 6.5% state sales tax rate, the 1.5% state sales tax rate of food, and transactions exempt from the sales tax would create and maintain accounting records reflecting their calculations of the tax credit amounts allowed.

Resources Required :

The proposal would require DFA to reprogram the AIRS tax return processing system and DFA accounting systems to provide for the tax credits allowed and apply the credits claimed to the eligible portion of the 6.5% and 1.5% state sales tax rates.

The proposal would require redesign of the excise tax reporting forms and instructions and amendment to the Sales Tax Rules. Any change in the design of the reporting forms and instruction sets must be completed by April 2013 for a change that would be effective between July 1 and December 31, 2013.

Time Required :

The programming and revision of the sales tax forms would not be available until January 1, 2014. Monthly sales tax forms are mailed semiannually with forms design for the July through December period requiring a completion by April 2013.

Procedural Changes :

Education of staff and a revision of the rules to allow for the credit. Education of the taxpayers in the proper method of calculating the credit. Revision of the reporting forms and instructions to allow for the credit.

Other Comments :

The calculation of the credit will be complicated for taxpayers. Taxpayers with computerized accounting systems could have an easier task in properly calculating their credits versus those that use manual accounting systems. The credit calculation will be for a portion of the interchange fees that the seller is billed and only for a portion of the interchange fees that were charged on sales taxes that were paid through credit or debit card.

There are many special excise taxes being collected at the time of the sale by a retailer. An example is the state tourism tax levied at a 2% rate on hotel rooms and tourist attractions. The taxpayer would have to first remove this tax, the local taxes, and the constitutional levies before calculating the amount of credit. The taxpayer would then have to allocate the portion of the interchange fee for the remaining tax to determine the eligible credit.

The proposal only allows an Arkansas taxpayer collecting state sales taxes to claim the credit. Out-of-state sellers are not included within the credit provisions and would be treated differently than in-state sellers. Arkansas as a member of the Streamlined Sales Tax system must treat all sellers equally. Constitutional concerns would also exist.

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Legal Analysis :

SB1185 establishes a sales and use tax deduction for interchange fees paid to credit card processors by retail merchants or sellers of taxable tangible personal property or taxable services in Arkansas. A credit card processor is essentially defined under the bill as an entity that directly or through licensed agents provides the services and infrastructure that are necessary to conduct debit or credit card purchases and that are used by merchants or sellers to accept debit and credit card payments. An interchange fee is defined under the bill as a fee established, charged, or received by a credit card processor for the purpose of compensating a taxpayer for its involvement in an electronic payment transaction. It should be noted that interchange fees are commonly understood as a fee charged to merchants by credit card processors to compensate credit card issuers for allowing the use of their cards to make retail purchases. As the bill essentially provides that interchange fees are used to compensate merchants for their involvement in electronic payment transactions, and as electronic payment transactions is not defined in the bill, it appears the bill should be amended to clarify and correct certain definitions.

When a consumer uses a debit, credit, or prepaid card to purchase merchandise or services, the merchant has to pay an interchange or "swipe" fee to facilitate the transaction. These fees vary in proportion to perceived security risk and are supposed to cover the risk of fraud, transactional costs, and other overhead. However, due to lack of negotiating power by merchants, it has become a major source of profit to banks. To reduce the impact on merchants, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 was amended, in part, to cap interchange fees and to authorize merchants to impose a \$10.00 minimum on credit card transactions and to provide discounts at the register to those who pay with cash or debit cards. As a further mechanism to reduce the costs of interchange fees to merchants, states have been working on legislation to prevent interchange fees from being calculated on the tax paid by a customer at the time of merchandise or service purchase. However, SB1185 extends beyond reducing the amount of interchange fees a merchant pays, but instead permits merchants to deduct the total amount of interchange fees paid from their state sales and use tax to the state. Under this bill, merchants would be reimbursed or subsidized by tax dollars for the interchange fees they pay in relation to credit and debit card transactions.

The bill also raises constitutional concerns. First, there are a number of sellers in this state that receive payment from consumers by debit or credit card but which do not make sales subject to sales and use tax in Arkansas. These merchants or sellers would not have tax dollars available to reimburse them for the interchange fees they are required to pay. These merchants are not afforded equal treatment with other merchants and are not afforded the same privileges and immunities under the law. Additionally, the state is constitutionally prohibited from lending credit for any purpose whatsoever. Subsidizing merchants for the interchange fees they pay with tax dollars due to the state, or essentially providing financial aid to these merchants, could be considered a loan of credit. See Halbert v. Helena-West Helena Indus. Dev. Corp., 226 Ark. 620, 291 S.W.2d 802 (1956).

In addition to the concerns raised above, it should be noted that there would be an unlimited amount of time for a taxpayer to claim a deduction for interchange fees and a refund would be permitted in the event that the deduction is more than the tax owed for the period in which the deduction is claimed.