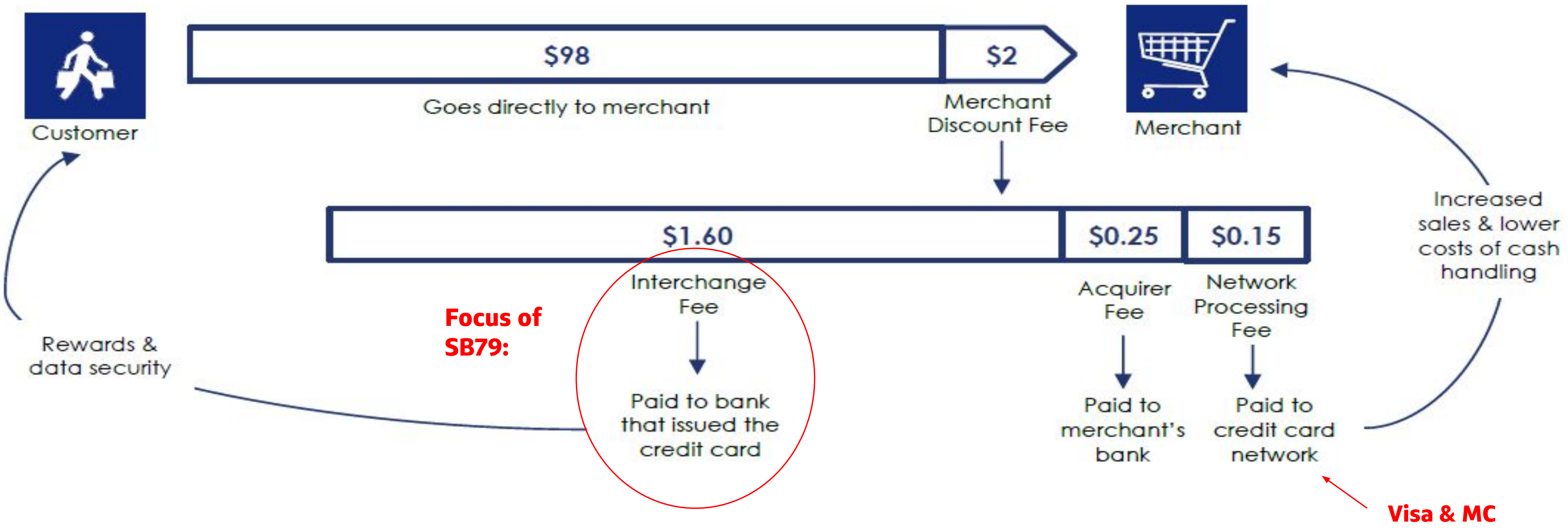
Interchange Legislation Materials

Alaska

May 9, 2025

What is interchange?

Interchange is one component of fees merchants pay to accept and process credit and debit cards. These fees, ~2% of a credit card purchase, pay for the services credit cards offer, including zero-liability fraud protection, rewards, and instant, hassle-free payments. Interchange is essential to operating the global payments ecosystem. Financial institutions re-invest interchange revenue to ensure continued innovation, efficiency, and safety for customers and businesses, cover fraud and nonpayment risk, and fund popular rewards programs.



Visa and MC do not receive interchange, card issuers do. Regardless of intent, SB79 takes revenue from Alaska community banks and credit unions, not from Visa & MC

Exempting tax and tip 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 interchange revenue since 2016**.
- A card issuer bears the **same credit and fraud risk from the tax portion of a transaction** as it does for the other portions.

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

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 % of total transaction. Increase in interchange expense means consumers are using credit and debit cards as their preferred payment method more frequently, and purchase volume is increasing.

In 2008, retailers used this handout referencing interchange as “$2 of every $100” (2%). Today, interchange rates are still ~2%

Interchange has <u>not gone up</u> and any rise in the total cost of acceptance is because:

- Purchase volume increased
- Credit cards are more popular than other payment methods, especially after Durbin amendment capped debit interchange and led to the elimination of debit card rewards
- Prices increased from inflation and other factors unrelated to card processing costs

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

AK Small Business Example		
Annual Revenue		$1 Million
Sales Tax Collected: 1.82%* (blended average local sales tax)	0.0182	$18.2K
Sales via Credit Card or Debit Card		
- Credit Card**	43%	$430K
- Debit Card**	23%	$230K
Sales Tax from Credit Card sales		$7.8K
Sales Tax from Debit Card sales		$4.2K
Average Credit Interchange:	2.30%	$180
Average Debit Interchange:	0.40%	$17
Interchange on Sales Tax from credit & debit sales per year		$197
Monthly "Savings" from Exemption Legislation		**$16**

AK Home Depot Example		
# of Stores in AK***		7
Annual Revenue Per Store (pre-sales tax)***		$63 Million
Gross Revenue (Sales + Sales Tax)		$449 Million
Sales Tax Collected: 1.82% (blended average local sales tax)	0.0182	$8.17 Million
Sales via Credit or Debit Card		
- Credit Card**	43%	$190 Million
- Debit Card**	23%	$101 Million
Sales Tax from Credit Card sales		$3.45 Million
Sales Tax from Debit Card sales		$1.84 Million
Average Credit Interchange:	2.30%	$79.4K
Average Debit Interchange:	0.40%	$7.4K
Interchange on Sales Tax from credit and debit sales per year		$86.7K
Monthly "Savings" from Exemption Legislation		**$7.2K**

- An AK small business with $1 million in taxable annual sales will reduce its interchange expense by ~$197/ yr. Home Depot will reduce its interchange expense in AK by ~$87K / yr.
- 30 states allow retailers to retain a small portion of sales tax for timely payment. (Alaska could consider a modest holdback for small businesses)
- 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.

EPC Electronic Payments Coalition

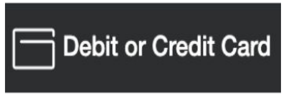
* Source: Tax Foundation ** Source: Visa Payment Panel *** Source: Home Depot Investor Relations site, 4Q 2024 earnings report ($599.92 sales per sq. ft, average store 105,000 sq. ft)

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



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***

EPC Electronic Payments Coalition

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

Restaurants want government to intervene and 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

Restaurant Receives $98

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 tipped staff, higher wages to non-tipped staff)

Rent or Mortgage to landlord / mortgage holder

Utility expenses

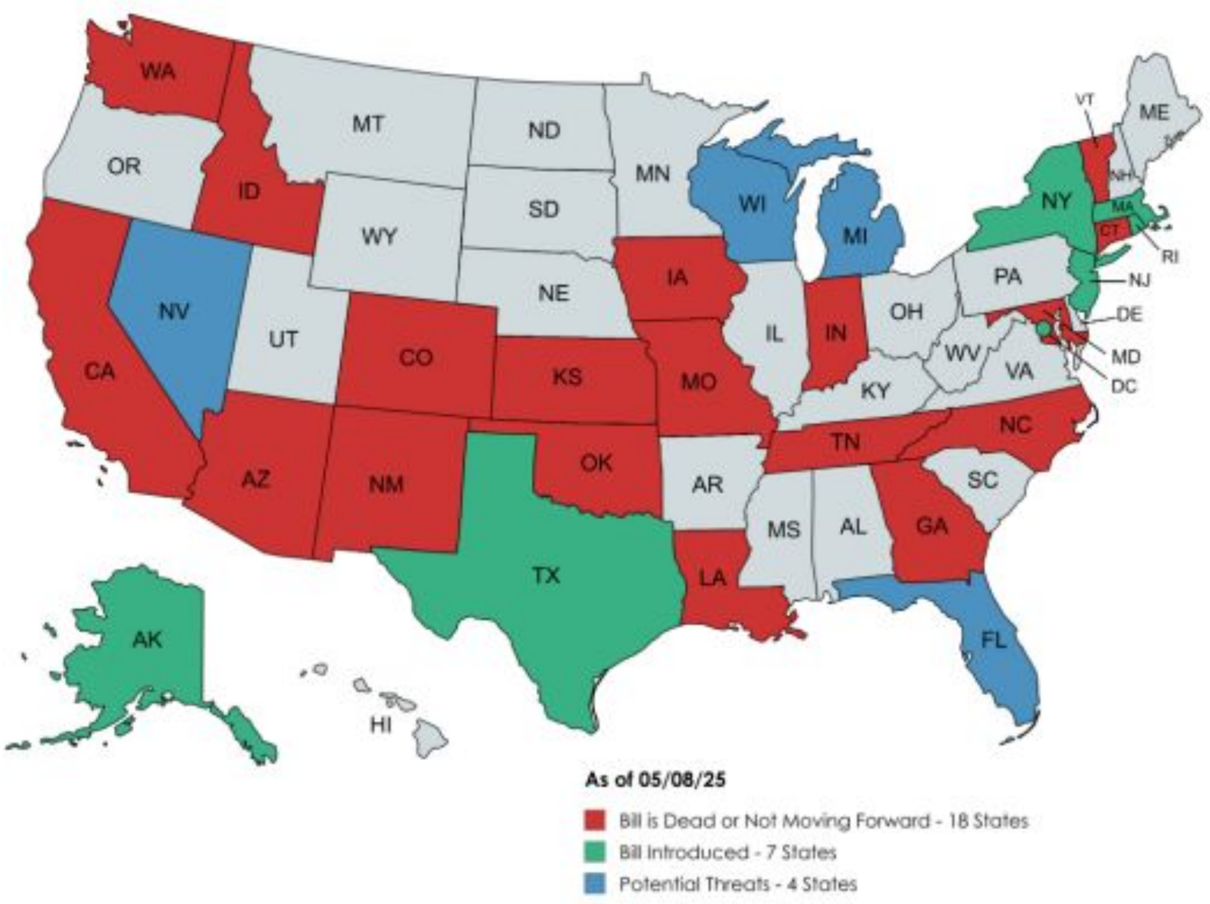
Insurance premiums

Food, beverage and equipment suppliers

“Sales tax and tips are different” doesn’t pass muster. Card issuer is floating 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

2025 Interchange Bills



- Bill defeated ~71 times in 31 states since 2006
- Only time signed into law was when it was inserted into Illinois' 1,275-page 2024 revenue bill as part of an end of session budget deal made without key stakeholders or legislative process and deliberation.
- This year, local retailer and restaurant groups are "flooding the zone" at the direction of their national trades and big box retailers. Bill filed in 25 states and already killed in 18 states. Has not become law in any state this year

Electronic Payments Coalition

Alaska could consider a retail collections allowance for small businesses. HB171 gives big box retailers a subsidy from AK financial institutions who are not involved in tax remittance process

No Sales Tax or No collections allowance	Limited / capped collections allowance	Uncapped collections allowance
No state sales tax: **AK**, DE, MT, NH, OR No allowance: CA, CT, DC, HA, IA, ID, MA, ME, MN, NC, NJ, NM, OK, RI, UT, VT, WA, WV	AL, AZ, AR, CO, FL, IL, KS, KY, LA, MD, MI, MS, ND, NE, NY, PA, SC, SD, TN, VA, WI, WY Allowance caps range from $360 - $20,000 per year	NV: 0.25% GA: 3% of first $3K, 0.5% of remainder OH: 0.75% IN: 1% TX: 1.75% w/ prepayment, 0.5% w/out MO: 2%
Least generous	***Modest***	***Most generous***

- Collections allowance is a more appropriate policy solution and is used in 30 states today
- Allowance applies to all sales tax, not only from credit and debit card transactions. Retailers have 30 day float to hold onto sales tax before remittance
- Interchange expense (all of it, not only portion from sales tax / tip) is tax deductible at federal and state levels
- Financial institutions are not involved in the sales tax remittance process. This is an issue between retailers and the State

Walmart and Home Depot reported $220BB in revenue in 4Q24. That is 15x Alaska's entire FY26 budget ($14.2BB). Yet they want a subsidy from Alaska community banks and credit unions to reduce their sales tax remittance costs.

Source: Walmart & Home Depot 4Q2024 earnings report, Alaska state budget

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

- On 12/20/24, 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). On February 6, the preliminary injunction was expanded to include out-of-state state chartered banks.

- This means IFPA and similar bills, if passed, might apply only to credit unions and in-state, state chartered banks. 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 to receive equal treatment or go out of business.

- 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."

- Motion for Summary judgement filed on March 17. State's response filed 4/23. Plaintiff's response filed 5/7. Next hearing 5/21

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

Other jurisdictions should not take up this issue while Federal litigation is pending

As in the IL case, federal courts should find that SB79 is preempted

Illinois Bankers Association et. al, v. Raoul

"The Court finds that Illinois Bankers have made a sufficient showing that the NBA likely preempts both the IFPA's Interchange Fee Prohibition and the Data Usage Limitation provision."

- **When a state law significantly interferes with or restricts a national bank's powers, National Bank Act (NBA) preemption means that the state law would not apply, as is likely the case here.**
- **National bank powers under the NBA include (but are not limited to): "all such incidental powers as shall be necessary to carry on the business of banking" and most notably including the offering of banking products and services (such as electronic payments) and pricing thereof.**
- **Legislation targeting networks should not change the result. The focus in a preemption analysis is whether there is significant interference with national banks' powers, not whether the law applies directly to national banks or some other entity.**
- **States cannot undermine the rights of national banks and other federally protected institutions by utilizing a workaround targeting their service providers.**

A state can't do indirectly what it can't do directly

Exempting sales tax and tip 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

If SB79 passes (and survives all legal challenges), financial institutions may make difficult decisions. Small businesses and consumers will lose while big box retailers gain

Market Exit

- A financial institution decides its cards won't work in Alaska
- A financial institution, particularly an out of state one, won't want to incur compliance costs or risk $1,000 per transaction fines
- A financial institution won't let a transaction go unsettled for an extended time waiting for receipts
- Tourism / travel industries will suffer if some cards don't work in Alaska

Refuse to Process Tax & Tip Portion

- A financial institution refuses to process tax on its cards in Alaska
- Proponents want financial institutions to process 100% of transaction, bear 100% of default risk, but only receive revenue on ~75-80% of tipped transaction. Why would financial institutions do that?
- Customers will have to pay taxes and tip by cash or check, which is inconvenient, frustrating and yields lower sales, tips and tax revenue

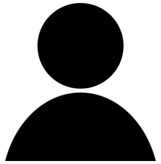
Reduction in Rewards / Fee Increases

- If financial institutions can't earn interchange service cost to process the entire transaction, rewards may get reduced or eliminated in AK
- Interchange funds rewards (cash back, miles, points) which are currently awarded on entire transaction (principal + tax + tip)
- Fees and interest on AK customers may be increased to offset interchange loss and/or fund rewards

- **Merchants are responsible for remitting taxes, regardless of customer payment method. Financial institutions are not involved in that process, nor should they be.**
- **Interchange is a fee for service that transfers risk from retailer to issuer, runs the global payment system, and funds rewards. If financial institutions are processing entire transaction, covering default risk on entire transaction, and providing rewards on entire transaction, interchange should apply to entire transaction**

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

Current System


Customer

$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

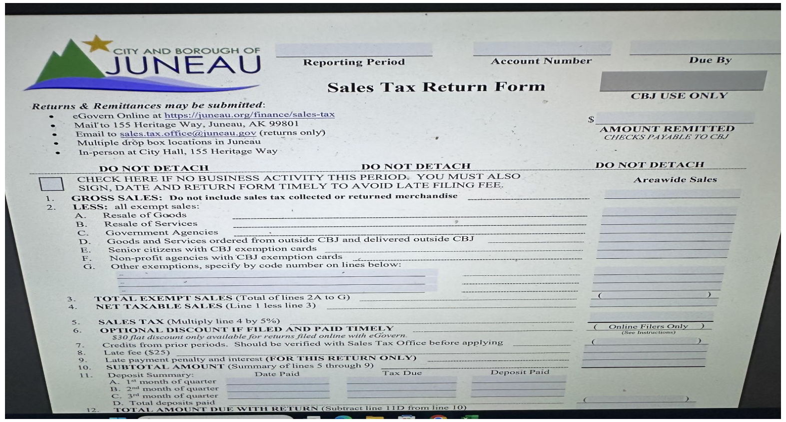
Customer may have to conduct two transactions, creating confusion and frustration. Retailer pockets additional $0.14, but that does not include their compliance costs. No savings to customer, no benefit to State. State will incur compliance costs too.

Submitting tax documentation at a later date does nothing to make the policy feasible. Issuers would still need specific tax data on every unique transaction

9,000 Retailers in AK*

9,300 Banks & Credit Unions in US*

Juneau Sales Tax Form



CITY AND BOROUGH OF JUNEAU

Reporting Period | Account Number | Due By

Sales Tax Return Form

CBJ USE ONLY

Returns & Remittances may be submitted:
- eGovern Online at https://juneau.org/finance/sales-tax
- Mail to 155 Heritage Way, Juneau, AK 99801
- Email to sales.tax.office@juneau.gov (returns only)
- Multiple drop box locations in Juneau
- In-person at City Hall, 155 Heritage Way

$ AMOUNT REMITTED
CHECKS PAYABLE TO CBJ

DO NOT DETACH DO NOT DETACH DO NOT DETACH

CHECK HERE IF NO BUSINESS ACTIVITY THIS PERIOD. YOU MUST ALSO SIGN, DATE AND RETURN FORM TIMELY TO AVOID LATE FILING FEE.

Areawide Sales

1. GROSS SALES: Do not include sales tax collected or returned merchandise
2. LESS: all exempt sales:
   A. Resale of Goods
   B. Resale of Services
   C. Government Agencies
   D. Goods and Services ordered from outside CBJ and delivered outside CBJ
   E. Senior citizens with CBJ exemption cards
   F. Non-profit agencies with CBJ exemption cards
   G. Other exemptions, specify by code number on lines below:
3. TOTAL EXEMPT SALES (Total of lines 2A to G)
4. NET TAXABLE SALES (Line 1 less line 3)
5. SALES TAX (Multiply line 4 by 5%)
6. OPTIONAL DISCOUNT IF FILED AND PAID TIMELY
   $30 flat discount only available for returns filed online with eGovern. (Online Filers Only) (See Instructions)
7. Credits from prior periods. Should be verified with Sales Tax Office before applying
8. Late fee ($25)
9. Late payment penalty and interest (FOR THIS RETURN ONLY)
10. SUBTOTAL AMOUNT (Summary of lines 5 through 9)
11. Deposit Summary: Date Paid Tax Due Deposit Paid
   A. 1st month of quarter
   B. 2nd month of quarter
   C. 3rd month of quarter
   D. Total deposits paid
12. TOTAL AMOUNT DUE WITH RETURN (Subtract line 11D from line 10)

Billions of transactions per year

- Municipal Sales Tax Forms in Alaska only capture 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 Alaska.
- Billions of credit and debit card transactions are processed in Alaska 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?