New Illinois Law Creates Windfall for Largest Corporate Mega-Stores

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Electronic Payments Coalition

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I. INTRODUCTION

Interchange, or the amount merchants pay to process credit and debit card transactions, is essential to the secure, hassle-free operations of the global card payment ecosystem. Interchange enables credit card companies to invest in fraud protection strategies to keep electronic payments secure. Interchange also partially funds generous reward programs that credit card issuers provide to customers.

Recently, the Illinois state legislature passed a revenue bill that would prohibit card issuers and networks from imposing interchange fees on sales taxes and gratuities associated with the sale of goods and services in the state.[1] The bill's interchange provision, which applies to all card payments, appears designed to offset a new $1,000-per-month cap on the discount merchants receive from the state in exchange for collecting sales taxes.[2]

The Illinois law, as well as similar legislative proposals being considered in Pennsylvania, Florida, and Texas, is sometimes framed as an opportunity to help businesses of all sizes tasked with collecting sales taxes on behalf of the state. In reality, however, these restrictive payment policies reward Walmart, Apple, and other corporate megastores while raising substantial costs for small businesses in Illinois (which comprise more than 99% of Illinois businesses).[3] At best, small businesses will experience marginal savings as a result of the bill and will also incur significant implementation costs to upgrade their payment systems. Consumers are also unlikely to be helped and ultimately may be worse off.

II. THE LAW'S RESTRICTIONS ON INTERCHANGE WILL MOSTLY BENEFIT LARGE RETAILERS

Mega-retailers are the clear beneficiaries of this legislation, while the impact on Main Street businesses will be small. Out of the estimated $118 million reduction in interchange paid by all businesses in the state, ten of the largest retailers in the country, including Walmart, Amazon, CVS, Costco, Home Depot, and Apple, are expected to soak up more than one-fifth of that amount (see Figure 1).[4] Meanwhile, forty of the

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[1] Payments Dive (2024), "Illinois heads toward landmark card interchange fee restrictions."

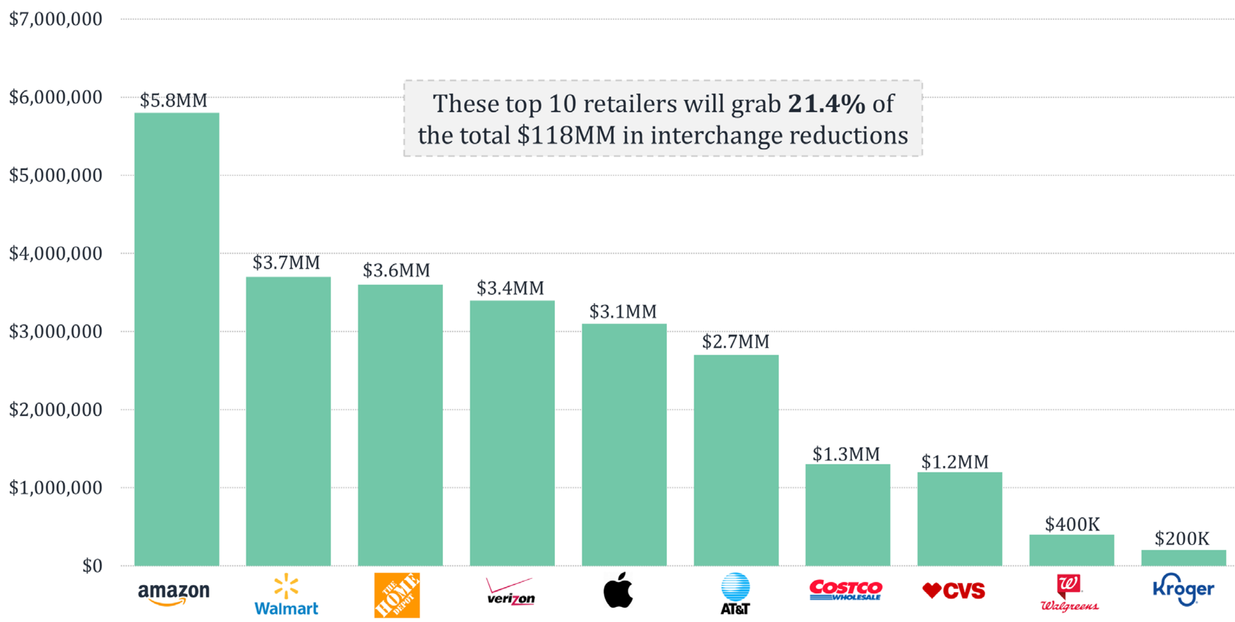
[2] Historically, the 1.75% discount merchants received on total sales taxes collected was not capped, thereby allowing large retailers to collect millions of dollars in discounts every year. The new law's $1,000 monthly cap on sales tax discounts will have no impact on businesses unless their monthly sales exceed $645,000 (equivalent to nearly $8 million in annual sales). As such, small businesses are unlikely to be affected, but the impact on Walmart, Home Depot, and other large retailers is likely to be substantial. See Ballard Spahr (2024), "Illinois Governor Expected to Sign Bill to Ban Interchange Fees on Sales Tax and Tips." Consumer Finance Monitor, June 7, 2024.

[3] U.S. Small Business Administration (2023), "Illinois Small Business Profile."

[4] EPC's calculation is estimated using the National Retail Federation's 2024 list of top 100 retailers. EPC narrowed the list to retailers with operations in Illinois and publicly available financial information on domestic sales. EPC also relied on the published figures from the Illinois state budget for estimated 2025 sales tax collection. The estimate uses Illinois blended state and city sales tax rate, while also accounting for idiosyncrasies in Illinois's sales tax law, such as a 0% sales tax rate on groceries and a 1% sales tax rate on medications. Additionally, the estimate relies on Federal Reserve data to estimate credit and debit interchange fees paid on sales taxes. The analysis assumes that each company's share of national revenue generated in Illinois is proportional to the number of stores within the state. For e-commerce retailers, EPC assumes that each company's share of national revenue generated in Illinois is proportional to Illinois' share of national GDP (3.9%). The projected savings explicitly address the sales tax portion of the proposed legislation but exclude any estimate or

largest U.S. retailers are expected to grab nearly 40% of the windfall (Figure 2).[5] Importantly, this estimate *excludes* almost half of the companies on the National Retail Federation's Top 100 Retailers list due to data limitations.[6] As such, corporate megastores will reap most of the interchange savings, leaving little more than scraps for true mom-and-pop style businesses the legislation claims to be helping.

Figure 1: Large Retailers Would Reap Lion's Share of Savings from Illinois Law



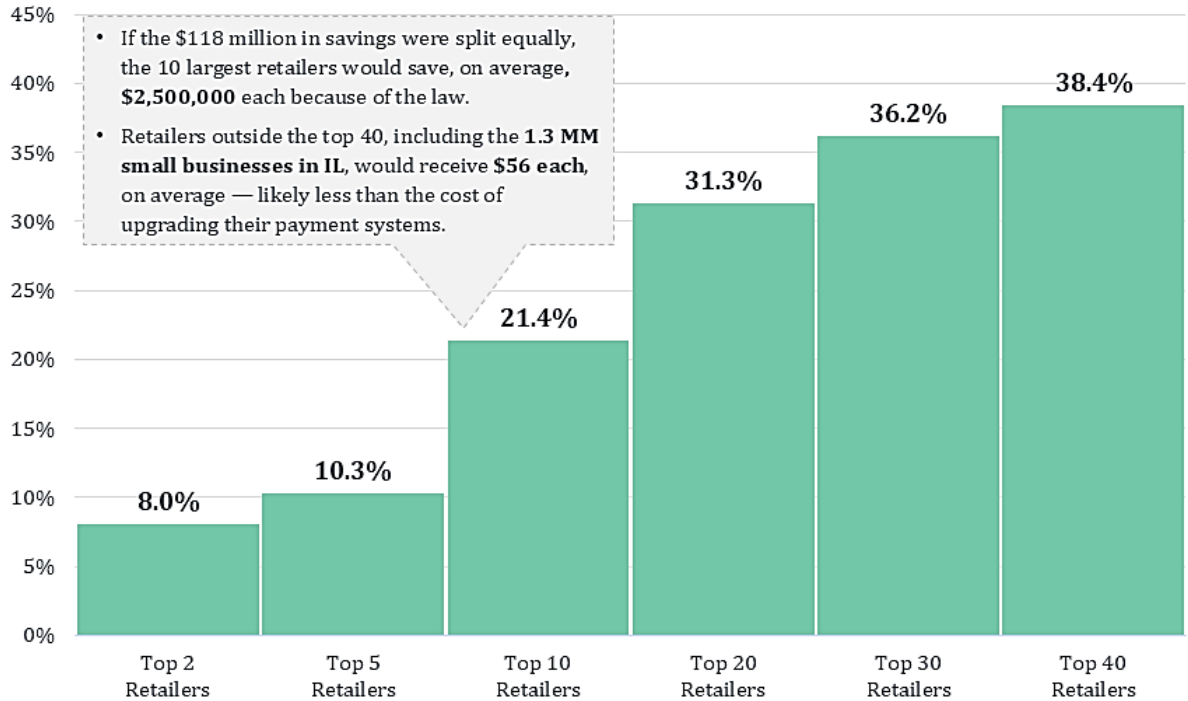
Data represent 2023 totals. For information on methodology, see Footnotes 4 - 6.

calculation on the potential savings from gratuity, the other stream of payment the proposed legislation attempts to prohibit from interchange fees.

5 *Ibid.*

6 Major retailers excluded from EPC's calculation include large private companies that do not report sales data publicly (e.g., Bass Pro Shops, PetSmart, Hobby Lobby) and large retailers that do not operate in Illinois.

Figure 2: After Large Retailers Take Their Share, Few Savings Remain for Small Businesses



Data represent 2023 totals. For information on methodology, see Footnotes 4 - 6.

Moreover, because a processing system to comply with the new law does not exist, many small firms will face higher costs due to this legislation because they will need to invest in new point-of-sale payment systems (hardware and software) capable of separating the sales tax portion of a transaction from the remaining transaction value (this capability is necessary to charge interchange on one component but not the other). For the largest corporate mega-stores, the additional cost is essentially meaningless to their bottom line given their size. For smaller firms, however, upgrading payment systems and training staff to operate them is a more significant additional financial expense and operational headache. Based on the small share of the annual interchange savings that will accrue to smaller firms, it will likely take years for many to offset the costs they incur to upgrade their payment terminals.

If smaller retailers opted out of purchasing new equipment, they would have to compile receipts manually or pay an accountant to calculate the portion of tax and tip paid on card transactions.

III. THE LAW'S INTERCHANGE RESTRICTIONS WILL ULTIMATELY HARM CONSUMERS

Importantly, there should be no expectation that this legislation will push retailers to pass on savings to their customers in the form of lower prices. After debit card interchange fees were capped in 2011 via the Durbin Amendment, only 1% of merchants reduced their prices in response.[7] Meanwhile, consumers suffered in a variety of ways: the disappearance of debit card rewards programs, decreased availability of

[7] Federal Reserve Bank of Richmond (2014), "The Impact of the Durbin Amendment on Merchants: A Survey Study."

free checking accounts, higher minimum balance requirements, and higher fees as banks took steps to offset the impact of the regulation.[8] There is no reason to believe retailers will respond differently once the Illinois legislation becomes law, but issuers will have less revenue from interchange payments to fund rewards programs and other critical services.

IV. CONCLUSION

This legislation, passed in the middle of the night, clearly rewards corporate megastores and the trade groups that represent them,[9] not small businesses or Illinois consumers. It will be a windfall for large retailers that will receive a disproportionate share of the benefits. Further, the loss of interchange revenue that results from this law may trigger pricing changes elsewhere in the electronic payments industry that ultimately harm small businesses, similar to what happened after the Durbin Amendment was implemented.

The imbalance is similar to the findings of the University of Miami's Indraneel Chakraborty report[10] on interchange legislation being considered in Congress. In his study, Chakraborty writes "small businesses would save significantly less, if anything, putting small retailers at a further competitive disadvantage [against the largest corporate mega-stores] than is currently the case."

Additionally, the Illinois law violates numerous federal laws designed to protect our nation's safe, sound banking system and facilitate easy commerce across state lines. Several associations have filed suit against the state as a result.

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[8] EPC (2023), "Out of Balance: How the Durbin Amendment Failed to Meet Its Promise."

[9] ABC45 (2024), "Swipe not once for twice? Some credit card users may have to pay sales tax separately."

[10] Indraneel Chakraborty, "Imposing Alternative Payment Networks on Credit Cards Will Likely Hurt Low Income Households and Small Merchants"