Research Plan: Vendor Compensation

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Support:

Deputy Executive Director Approval: Initial: MWB Date: 5-16-2024

Executive Director Approval: Initial: Date: 5/16/24

Purpose

To study the collection and remittance of state and local taxes, including the cost to businesses (e.g., payment card interchange fees) and how compensating vendors in Tennessee compares to other states.

Background

State and local governments in Tennessee rely on sellers (i.e., vendors) to collect sales and other taxes (e.g., liquor-by-the-drink and hotel taxes) at the point of sale. Sellers bear some cost to collect these taxes, including costs of training staff, documenting, customer service related to sales tax issues, software and licensing, programming and servicing cash registers, preparing tax returns, and dealing with tax audits and appeals. The study request makes special note of interchange fees (i.e., swipe fees) that businesses pay to payment card companies whenever a customer pays with a credit or debit card. Swipe fees are calculated as a percentage of the total transaction, including the tax portion of the transaction. According to the fiscal note for Senate Bill 132 and House Bill 615 in the 113th General Assembly—which would have prohibited payment card companies from charging swipe fees on taxes in Tennessee—the estimated cost to businesses for swipe fees on the tax portion of transactions totaled an estimated $57.9 million in fiscal year 2023-24.

To offset such costs and encourage accurate, on-time collection, most states allow sellers to retain some of the taxes they collect—a practice known as vendor compensation (also known as vendor discounts). Of the 47 states with either a state or local sales tax, 30 states, including Tennessee, have vendor compensation, and 17 states do not, according to Avalara, a tax compliance business. Out-of-state sellers with less than $100,000 in sales in Tennessee and that do not sell through a marketplace facilitator are not required to collect and remit Tennessee's sales tax, but if they do, Tennessee pays tax compliance businesses to provide free sales tax compliance services for them.

Vendor compensation was included with Tennessee's sales tax when it was first enacted in 1947 at 2% of all sales tax due but was later reduced in 1980 from 2% to 1.5% on sales tax due exceeding $2,000 per month. Except for the out-of-state sellers mentioned previously, vendor compensation was eliminated in 2000 before being restored for fiscal year 2022-23 when sellers could request vendor compensation of 2% of state tax due up to $25 per sales tax return that was timely filed. This resulted in $14 million in vendor compensation, about 0.1% of the sales taxes collected in fiscal year 2022-23, according to data from the Tennessee Department of Revenue. However, in a 2006 national study by PricewaterhouseCoopers, sellers reported collections cost an average cost of about 3% of the sales tax collected, or greater than what vendor compensation allows for. Small sellers reported greater costs as a percentage of collections than large sellers did (13% versus 2% of collections).

Senate Bill 1140 by Senator Lundberg and House Bill 886 by Representative Hawk in the 113th General Assembly would have restored vendor compensation for sales tax collections with the same rates and cap as used in fiscal year 2022-23. As later amended and passed, however, the bill requested the Commission study the collection of sales and use taxes at the point of sale by businesses in Tennessee, specifically addressing three questions:

- the cost to businesses of collecting and remitting state and local taxes;
- the cost to the State of Tennessee for reasonable remuneration for sales tax collection, including vendor compensation, to businesses as compared to other states; and
- The cost to businesses of payment card fees on the tax portion of transactions, including interchange fees and other fees associated with payment processing, as well as the cost to businesses of handling cash.

Define the Problem

Vendor compensation is intended to encourage accurate, on-time collection and to compensate vendors for the cost of collecting and remitting sales tax; however, allowing vendors to retain a portion of tax they collect would result in forgone revenue for the state, and potentially for local governments if it were also applied to local sales tax, which could reduce revenue available for state and local programs.

Assemble Some Evidence

- Review referred legislation, Senate Bill 1140, House Bill 886, to determine what it asks the commission to study.
- Interview the sponsor of the legislation.
- Interview other stakeholders to determine what is driving this issue, e.g.:
    - State and local officials
    - Tennessee Department of Finance and Administration
    - Tennessee Department of Revenue
    - Retail businesses
    - Banks and payment card businesses
    - Tax collection businesses
    - Other subject matter experts
- Review the history of vendor compensation in Tennessee.
- Review vendor compensation in other states.
- Review relevant literature.

Proposed Research Timeline

- **Problem Statement and Research Plan**
  - May 2024
- **Research**
  - Assemble evidence (Jun-August 2024)
  - Construct alternatives and select criteria (August-September 2024)
  - Convene panel for discussion at Fall Commission Meeting
  - Project outcomes, confront trade-offs, and select draft recommendations (September 2024)
- **Storyboard, Outline, and Write the Report**
  - (October-November 2024)
- **Draft Report to the Commission for Comments**
  - November/December 2024 Commission Meeting
- **Final Report to Commission for Approval**
  - January 2025 Commission Meeting

House Finance, Ways, and Means 1

Amendment No. 1 to HB0886

Hazlewood
Signature of Sponsor

AMEND Senate Bill No. 1140 House Bill No. 886*

by deleting all language after the enacting clause and substituting instead the following:

SECTION 1.

(a) The Tennessee Advisory Commission on Intergovernmental Relations (TACIR) is directed to perform a study of the collection and remittance of state and local taxes, including sales and use taxes, collected at the point of sale by businesses in this state. The study must include, but not be limited to, examinations of:

(1) The cost to businesses of collecting and remitting state and local taxes;

(2) The cost to the State of Tennessee for reasonable remuneration for sales tax collection, including vendor compensation, to businesses as compared to other states; and

(3) The cost to businesses of payment card fees on the tax portion of transactions, including interchange fees and other fees associated with payment processing, as well as the cost to businesses of handling cash.

(b) All appropriate state departments and agencies shall aid TACIR in connection with the study required by subsection (a). It is the legislative intent that this study be conducted within existing resources.

(c) On or before January 31, 2025, TACIR shall report its findings and recommendations, including any proposed legislation, to the chairs of the Finance, Ways and Means committees of the House of Representatives and the Senate and to the General Assembly's legislative librarian.

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