

**Regulating State Interchange Fees:
Evaluating the Likely Effects of the IFPA**

Julian Morris & Ben Sperry

ICLE White Paper 2025-07-07

Executive Summary

The Illinois Interchange Fee Prohibition Act (IFPA) is a novel legislative measure that, if implemented, would prevent payment-card issuers, networks, and processors from charging interchange fees on those portions of card transactions that represent gratuities or state or local sales taxes. While ostensibly aimed at protecting merchants from the burden of paying interchange fees on sales taxes and gratuities, the law would create a host of economic and legal problems that far outweigh its modest purported benefits.

The IFPA introduces a complex two-tier compliance mechanism, including a real-time exemption system that would require merchants to transmit detailed tax and gratuity data during payment authorization, and a rebate system that would allow merchants to retroactively recover interchange fees. Both pathways present substantial logistical and technological challenges for payment networks, processors, and merchants, with significant accompanying compliance costs and systemic inefficiencies.

Economically, interchange fees are not merely transaction costs; they are the mechanism by which payment networks balance the two-sided market of merchants and consumers, funding consumer rewards, insurance, fraud prevention, and card-system innovations. By prohibiting interchange fees on sales taxes and gratuities, the IFPA would disrupt the established economic balance of the payments ecosystem, imposing revenue losses on banks that would likely be offset through reduced consumer rewards, higher card fees, or increased borrowing costs. Historical precedents from interchange-fee regulations in the United States (the “Durbin amendment”), the EU, and Australia confirm that such interventions generally result in diminished consumer benefits without clear price reductions from merchants.

The IFPA would also have significant extraterritorial effects, imposing Illinois-specific standards on national payment systems, necessitating costly and inefficient operational adjustments nationwide. If other states were to follow suit, it would cause fragmentation of the national payments system, leading to higher transaction costs, reduced innovation, and decreased overall efficiency. The law also raises significant constitutional and legal questions, particularly concerning federal preemption. Banks and credit unions have challenged the act, arguing that it is preempted by the federal National Bank Act (NBA) and Home Owners' Loan Act (HOLA). A federal court has preliminarily enjoined enforcement against nationally chartered banks and out-of-state banks. Originally scheduled to enter into force July 1, the preliminary injunction means the act’s implementation will be delayed, perhaps indefinitely.

Ultimately, the IFPA’s minimal and concentrated merchant benefits would be substantially outweighed by broader economic harms to consumers, banks, and the payments infrastructure. Given the preliminary legal injunctions and the significant practical challenges to implementation, the law’s long-term viability is questionable. If replicated elsewhere, it could severely disrupt the unified and efficient national payment systems integral to contemporary commerce.

I. Introduction

In June 2024, Illinois enacted the Illinois Interchange Fee Prohibition Act (“IFPA”), a first-of-its-kind law aimed at reshaping the economics of credit- and debit-card transactions in the state, but with implications far beyond.¹ The IFPA prohibits payment-card issuers, networks, and processors from charging or collecting interchange fees on those portions of a transaction that represent gratuities or state or local sales taxes.

If implemented, when a consumer pays by card at an Illinois merchant, that merchant would be able to deduct or recoup the interchange fee on the sales tax and tip component of the purchase. Proponents claim this will relieve merchants (and, ultimately, consumers) from paying fees on charges that do not constitute the merchant’s revenue (*i.e.*, taxes passed through to the government, or tips passed through to employees). As we document in this white paper, however, the reality would be rather different.

Originally scheduled to take effect on July 1, the IFPA represents a novel intervention into the payment-card ecosystem; no other government anywhere in the world has attempted to prohibit the retention of only one part of the interchange fee. The act’s notional premise is to reallocate the costs of sales-tax collection from merchants and taxpayers to card-issuing banks.² As we have previously noted, however, these costs would be substantially passed on to consumers.³ Moreover, the act would, if implemented, disrupt the intricate economic balance of the payment-card system and impose significant compliance burdens that would outweigh any putative benefits.

For good reason, the law currently faces serious legal challenges. Specifically, in August 2024, the Illinois Bankers Association, American Bankers Association, America’s Credit Unions, the Illinois Credit Union League, and the Illinois Retail Merchants Association brought a motion for pre-enforcement injunctive relief from the IFPA.⁴ As of this writing, the judge had issued a temporary injunction barring Illinois’ attorney general from enforcing the legislation against federally chartered banks and out-of-state banks.⁵

This paper extends our previous analysis, offering more detailed examination of the IFPA from a law & economics perspective. It situates the act within broader debates on the cost of tax compliance, the regulation of interchange fees, and the question of who should bear the cost of compliance.⁶ It

¹ Illinois Interchange Fee Prohibition Act, 815 Ill. Comp. Stat. § 151/150-5 *et seq.*

² *Infra* Section 2.

³ See Julian Morris, *State Regulation of Interchange Fees*, INT’L CTR. L. & ECON. (Nov. 15, 2024), <https://laweconcenter.org/resources/state-regulation-of-interchange-fees>.

⁴ See *Illinois Bankers Association et al. v. Kwame Raoul*, 2024 WL 5186840 (N.D. Ill., Aug. 15, 2024) [hereinafter “IBA I”].

⁵ See *id.*; *Illinois Bankers Ass’n v. Kwame Raoul*, 2025 WL 409060 (N.D. Ill., Feb. 6, 2025) [hereinafter “IBA II”].

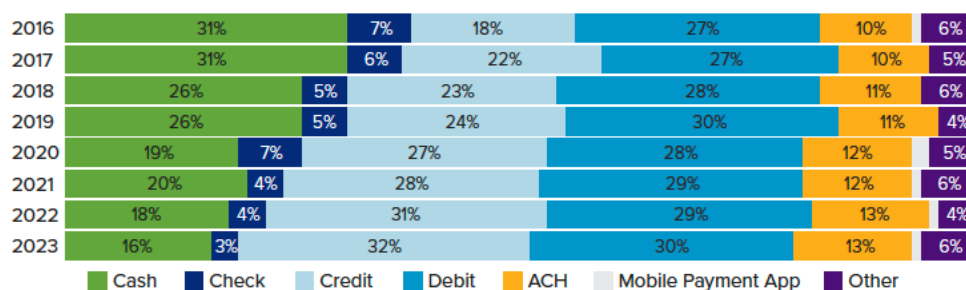
⁶ Morris, *supra* note 3.

also delves more deeply into the extraterritorial implications of the IFPA, as well as its constitutionality.

A. The Benefits of Electronic Payments and the Role of Interchange Fees

Electronic payments have become indispensable in modern commerce. Studies show that payment cards (whether a physical card or a phone app) are, for most purposes, superior to cash transactions.⁷ For consumers, they enable greater convenience (there is less need to obtain and carry cash) and security (they come with sophisticated fraud protections). Credit cards also offer the benefit of a line of credit that is interest-free if the previous month's balance is paid in full by the due date. Many cards also come with other benefits, including purchase-protection insurance, travel insurance, and cashback or other rewards (such as airline miles or hotel points). These considerable benefits explain why most consumers prefer to pay using a payment card (Figure 1).

FIGURE 1: Payment-Instrument Share as Proportion of Number of Payments



SOURCE: Federal Reserve Board⁸

For merchants, cards also offer significant benefits relative to cash, including faster check-outs, increased sales, and protection against fraud and theft.⁹ When Chicago quick-serve restaurant chain Epic Burger went cashless in 2017, founder David Friedman explained that he did so to increase speed and safety, and to reduce counting errors.¹⁰ When the Mercedes-Benz Stadium in Atlanta went cashless in 2018, it reported significantly faster transaction times, an increase in per-capita spending, and substantial reductions in total costs, underscoring the benefits to merchants of

⁷ See Julian Morris & Ben Sperry, *The Cost of Payments: A Review*, INT'L CTR. FOR L. & ECON. (Aug. 28, 2024), <https://laweconcenter.org/resources/the-cost-of-payments-a-review>.

⁸ Berhan Bayeh et al., *2024 Findings from the Diary of Consumer Payment Choice*, FED. RSRV. (2024), available at <https://www.frbservices.org/binaries/content/assets/crsocms/news/research/2024-diary-of-consumer-payment-choice.pdf>.

⁹ Morris, *supra* note 3; Claire Wang, *Cash Me If You Can: The Impacts of Cashless Businesses on Retailers, Consumers, and Cash Use*, CASH PROD. OFF. FED. RSRV. SYS. (2019), available at <https://www.frbsf.org/wp-content/uploads/sites/7/Cash-Me-If-You-Can-August2019.pdf>.

¹⁰ Daniel Gerzina, *Epic Burger Is Now Cashless, Tamale Spaceship Closes Wicker Park Restaurant, More Intel*, EATER CHI. (Jun. 21, 2017), <https://chicago.eater.com/2017/6/21/15846364/epic-burger-cashless-tamale-spaceship-closed-wicker-park-restaurant-am-intel>.

electronic payments.¹¹ Sports stadiums and restaurants both in Illinois and across the country have followed suit.¹²

Payment systems can only function with participation by both buyers (consumers) and sellers (merchants). Trust is fundamental to that participation, and the willingness of merchants and consumers to trust payment cards is underpinned by the billions of dollars of investments in innovation made by payment networks, by the banks that issue cards (issuers) and the banks and other payment-service providers that process payments on behalf of merchants (acquirers) in secure systems, as well as in ongoing maintenance of those systems.¹³ Meanwhile, consumers will only be motivated to use cards if they perceive substantial benefits, which in many cases includes the aforementioned insurance and rewards. These costs are in large part recouped by issuing banks through the retention of an “interchange fee.”¹⁴

Despite the enormous benefits generated by payment cards for merchants, consumers, and society as a whole, the role of interchange fees remains poorly understood by the public. Indeed, even relatively knowledgeable commentators repeatedly assert that interchange fees are a “transaction cost.”¹⁵ From an economic perspective, this is not correct. While the interchange fee *does* cover certain transaction costs, such as fraud detection and prevention and the system’s overall maintenance, a large proportion of the fee is, in fact, a *transfer* from merchants to consumers, covering various consumer benefits, such as purchase-protection insurance and rewards.

Economists call such transfer payments “cross-side subsidies,” as they go from one side of the market (in this case, merchants) to the other (consumers).¹⁶ Such payments are more-or-less ubiquitous in two-sided markets. For example, merchants (advertisers) subsidize readers of newspapers and users of search engines and smartphone apps. The importance and value of such cross-side subsidies has long been established in the economics literature and was recognized by the U.S. Supreme Court:

Sometimes indirect network effects require two-sided platforms to charge one side much more than the other. For two-sided platforms, “the [relative] price structure matters, and platforms must design it so as to bring both sides on board.” The optimal price might require charging the side with more elastic demand a below-cost (or even negative) price. With credit cards, for example, networks often charge cardholders a lower fee than merchants because cardholders are more price sensitive. In fact, the network might

¹¹ *Id.*

¹² Morris, *supra* note 3.

¹³ See Julian Morris, *The Hidden Wealth of Payment Cards: How Innovations in Payments Transform Society*, INT’L CTR. L. & ECON. (Dec. 19, 2024), <https://laweconcenter.org/resources/the-hidden-wealth-of-payment-cards-how-innovations-in-payments-transform-society>.

¹⁴ See Todd J. Zywicki, *The Economics of Payment Card Interchange Fees and the Limits of Regulation*, INT’L CTR. L. & ECON. (Jun. 2, 2010), available at https://laweconcenter.org/images/articles/zywicki_interchange.pdf.

¹⁵ See Aaron Klein *et al.*, *How Better Payment Systems Can Improve Public Transportation*, BROOKINGS CTR. REGUL. MKT. (2023), available at www.brookings.edu/wp-content/uploads/2023/01/20230109_CRM_Klein_TransitPayments_final.pdf.

¹⁶ Morris, *supra* note 3.

well *lose* money on the cardholder side by offering rewards such as cash back, airline miles, or gift cards. The network can do this because increasing the number of cardholders increases the value of accepting the card to merchants and, thus, increases the number of merchants who accept it. Networks can then charge those merchants a fee for every transaction (typically a percentage of the purchase price). Striking the optimal balance of the prices charged on each side of the platform is essential for two-sided platforms to maximize the value of their services and to compete with their rivals.¹⁷

B. Interchange-Fee Regulation and the IFPA

The public's general lack of understanding of the role of interchange fees has contributed to a situation in which many larger merchants have been able to claim—often unchallenged in the media—that prevailing fees are “excessive.” Some of these merchants appear to want consumers to continue to use payment cards but don't want to contribute to the cross-side-subsidy component of interchange fees that enhances consumers' incentives to use their cards. Others may have a more nefarious motive: they understand that the introduction of price controls on payment cards would reduce card use overall, but believe they would gain: their larger scale and scope enables them to offer other inducements, such as merchant-specific loyalty rewards, so they could gain business away from smaller merchants for whom the loss of interchange-fee-funded incentives would be more detrimental.

Though largely driven by these larger merchants' interests, the IFPA is couched in language that would make it appear to be motivated by a desire to help smaller merchants and consumers. As we show in this paper, the IFPA would disrupt a nationally integrated payment system, imposing costly compliance burdens on out-of-state issuers, and cause economic harm through adjustments in card rewards and card or bank-account fees. Moreover, the IFPA raises serious constitutional questions under the Dormant Commerce Clause and federal preemption doctrines.

The paper is organized as follows. Section II explains the IFPA's provisions and contextualizes them within Illinois's longstanding and generous sales-tax-collection allowance. Section III examines the “sales tax exception” by comparing sales-tax collection with other business-tax obligations and evaluating the justifications for merchant compensation. Section IV explores the IFPA's extraterritorial effects, including its impact on out-of-state issuers, as well as anticipated responses like adjustments in rewards and fees, and expected legal challenges. Section V draws together the economic distortions, legal vulnerabilities, and broader implications of the act, ultimately concluding that the IFPA is both economically unsound and likely preempted by federal law.

II. Explaining the IFPA

For decades, Illinois has distinguished itself by allowing merchants to retain a significant portion of the sales tax they collect from consumers as compensation for the administrative burden of tax remittance. Prior to recent reforms, Illinois law permitted retailers to deduct 1.75% of the sales tax

¹⁷ *Ohio v. American Express*, 585 U.S. 529, (2018) (internal citations omitted).

collected with no cap. This is a practice that, in aggregate, the Illinois Policy Institute estimates cost the state approximately \$186 million annually.¹⁸

Until recently, many states permitted merchants to apply a “retailer’s discount,” presumably to offset the costs of manually recording and remitting sales taxes. In some cases, it was also used to encourage electronic reporting. Over time, however, as electronic filing became ubiquitous and administrative costs diminished, many states capped or eliminated such allowances.¹⁹ In contrast, Illinois’s uncapped policy came to be viewed as a windfall for high-volume merchants, particularly large chains that could capture six- or seven-figure annual sums from the discount.²⁰

Facing fiscal pressures, Gov. J.B. Pritzker in 2019 proposed capping the retailer discount at \$1,000 per month, which was estimated to generate an additional \$75 million in state revenue and \$58 million in revenue to local governments, while only affecting around 2,400 of the largest merchants, according to the governor’s budget office.²¹ But the move was resisted by the Illinois Taxpayers Federation and merchant groups.²²

Pritzker tried again in subsequent years but was repeatedly rebuffed.²³ In 2024, his budget office claimed the measure would result in \$101 million in additional revenue to the state and \$85 million to local governments.²⁴ Again, the measure faced opposition, mainly from large retailers. While the effective \$12,000 annual cap was generous compared to the caps imposed in other states, it represented a significant reduction from the six- or seven-figures many larger stores were previously able to reap. Indeed, Illinois Department of Revenue Director David Harris noted that, while only 2-3% of retailers would be affected by the cap, it would have “a significant impact on very large retailers.”²⁵

¹⁸ See Patrick Andreisen, *Illinois Retailers Taxed \$186M by Capping Sales Tax Credit*, ILL. POL’Y (May 30, 2024), <https://www.illinoispolicy.org/illinois-retailers-taxed-186m-by-capping-sales-tax-credit>.

¹⁹ See *Sales and Use Tax*, WIS. DEPT. REVENUE (Feb. 23, 2018), available at <https://www.revenue.wi.gov/DORReports/salusetx.pdf> (for example, neighboring Wisconsin reduced its discount to 0.5% of the tax liability and, in 2009, it capped its discount at \$1,000 per filing period); *Sales Tax by State: How to Discount Your Sales Tax Bill*, TAXJAR (Dec. 19, 2024), <https://www.taxjar.com/blog/file/state-sales-tax-discounts>.

²⁰ Philip Mattera & Leigh McIlvaine, *Skimming the Sales Tax: How Wal-Mart and Other Big Retailers (Legally) Keep a Cut of the Taxes We Pay on Everyday Purchases*, GOOD JOBS FIRST (2008), available at <https://www.goodjobsfirst.org/wp-content/uploads/docs/pdf/skimming.pdf>.

²¹ See Mary Hansen, *Unpacking Pritzker’s Tax Proposals: Retail Discount*, NPR ILL. (Mar. 7, 2019), <https://www.nprillinois.org/illinois-economy/2019-03-07/unpacking-pritzkers-tax-proposals-retail-discount>.

²² *Id.*

²³ Richard M. Silverman, *Illinois Gov. J.B. Pritzker’s 2022 Budget Proposes Numerous Business Tax Changes*, TAX. UPDATE (Feb. 22, 2021), <https://www.sidley.com/en/insights/newsupdates/2021/02/gov-jb-pritzkers-2022-budget-proposes-numerous-business-tax-changes>.

²⁴ See Jerry Nowicki, *Pritzker Agency Heads Questioned on \$1.1 Billion Revenue Proposals*, CAP. NEWS ILL. (Mar. 14, 2024), <https://capitolnewsillinois.com/news/pritzker-agency-heads-questioned-on-1-1-billion-revenue-proposals>.

²⁵ *Id.*

Walmart alone was estimated to pocket more than \$70 million annually nationwide from various states' sales-tax allowances, with Illinois' policy contributing significantly to that sum.²⁶

A. Legislative Quid Pro Quo: Large Merchant Interests and the IFPA

In the context of this friction, the IFPA was conceived as a compromise: a legislative bargain between Illinois lawmakers and the interests of large merchants. By capping the longstanding sales-tax allowance, Illinois lawmakers effectively recouped revenue that had previously been retained by merchants. In exchange, the General Assembly offered merchants a prohibition on interchange fees applied to sales taxes and gratuities.

At one level, the IFPA appears to shift the burden of collecting sales taxes from the government to the banking sector. Legislators could thus present it as a win for Illinois taxpayers, who would no longer subsidize merchants via an uncapped collection allowance. Instead, the banks would pay. Legislators could claim to be championing small businesses against big banks and “unfair fees,” while also plugging budget holes.

In reality, IFPA is a blatant sop to the interests of large merchants, who have been pushing for interchange-fee price controls for years. On a webpage devoted to “swipe fees,” the Illinois Retail Merchants Association (IRMA) states that it “has led the way in limiting these fees, working with Gov. JB Pritzker, Senate President Don Harmon, House Speaker Emanuel ‘Chris’ Welch and members of the General Assembly to pass the Interchange Fee Prohibition Act.”²⁷

While IRMA contends that “eliminating interchange fees on taxes and tips will save businesses and consumers millions of dollars a year,”²⁸ the major beneficiaries would be high-volume merchants. A significant share of the savings from eliminating interchange on taxes and tips (more than one-fifth of the total) would accrue to just 10 of the nation's biggest retailers.²⁹ Meanwhile, the costs, as will be discussed below, would fall mainly on consumers.

B. Key Provisions of the IFPA

The IFPA seeks to ensure that, if a purchase includes Illinois state or local sales tax, or if a customer adds a tip on a card payment, the portion of the transaction corresponding to the tax or tip would not incur interchange fees.³⁰

²⁶ Mattera & McIlvaine, *supra* note 20.

²⁷ *Swipe Fees*, ILL. RETAIL MERCHS. ASS'N, <https://irma.org/government-affairs/policy-and-positions/swipe-fees> (last visited Apr. 19, 2025).

²⁸ *Id.*

²⁹ *New Illinois Law Creates Windfall for Largest Corporate Mega-Stores*, ELEC. PAYMENTS COAL. (2024), available at <https://guardyourcard.com/wp-content/uploads/2024/10/Illinois-State-Sales-Tax-Interchange-Report-9.24.24.pdf>.

³⁰ Public Act 103-0027, 103rd Gen. Assemb., Regul. Sess. (Ill. 2024); Illinois Interchange Fee Prohibition Act, 815 Ill. Comp. Stat. § 151/150-1 *et seq.*

The core operative provision of the IFPA provides that no person or entity involved in processing an electronic payment may “receive or charge” any interchange fee on the portion of the transaction that represents sales tax or gratuity. In practice, this means that, for a given credit- or debit-card sale in Illinois, the merchant would not have to pay interchange fees on the dollars that would be remitted as sales tax, nor on any tip amount added by the customer. To effectuate this rule, the act creates two compliance pathways: a real-time exemption and a rebate.

1. Real-time exemption

§150-10(a) outlines the primary means by which merchants would exclude the tax and tip portions from interchange:

An issuer, a payment card network, an acquirer bank, or a processor may not receive or charge a merchant any interchange fee on the tax amount or gratuity of an electronic payment transaction if the merchant informs the acquirer bank or its designee of the tax or gratuity amount as part of the authorization or settlement process for the electronic payment transaction.³¹

In order to avail itself of this option, the “merchant must transmit the tax or gratuity amount data as part of the authorization or settlement process to avoid being charged interchange fees on the tax or gratuity amount of an electronic payment transaction.”³² In practical terms, this means merchants’ point-of-sale systems would have to distinguish the sales-tax and gratuity portions of the transaction, and include that information in the electronic message sent to the network for authorization/clearing. If the merchant does so, the issuer and network are on notice to exclude that portion from any interchange calculation.

2. Rebate

§150-10(b) offers an alternate method by which merchants could recoup interchange fees already paid:

A merchant that does not transmit the tax or gratuity amount data in accordance with this Section may submit tax documentation for the electronic payment transaction to the acquirer bank or its designee no later than 180 days after the date of the electronic payment transaction, and, within 30 days after the merchant submits the necessary tax documentation, the issuer must credit to the merchant the amount of interchange fees charged on the tax or gratuity amount of the electronic payment transaction.³³

In other words, if the tax or tip data isn’t transmitted during authorization, the merchant could later submit documentation of the tax/tip amounts to be reimbursed or credited for any interchange fees charged on those amounts. This two-track approach was likely included to accommodate smaller

³¹ Illinois Interchange Fee Prohibition Act, 815 Ill. Comp. Stat. 151/150-5, -10(a) (2024).

³² *Id.*

³³ *Id.* at §150-10(b).

merchants for whom the costs of upgrading payment systems would be large relative to the deduction or rebate of interchange fees.

3. *Anti-circumvention and penalty provisions*

To reinforce the law's intent, §150-10(d) prohibits circumvention. It states it is “unlawful for an issuer, payment card network, acquirer bank, or processor to alter or manipulate the computation and imposition of interchange fees” in a way that would effectively negate the fee exemption on taxes and tips.³⁴ This anti-circumvention clause aims to prevent creative adjustments, such as increasing the interchange rate on the non-tax portion of the sale to compensate for the forbidden portion, or imposing equivalent fees under a different label. For example, an issuer could otherwise attempt to charge a higher percentage on the taxable base amount of the sale to end up with the same total fee as before; §150-10(d) seeks to bar that tactic.

The law also includes penalty provisions for violations; specifically, each violation of the IFPA is “subject to a civil penalty of \$1,000 per electronic payment transaction.”³⁵

4. *Breadth*

In practice, interchange fees are set by networks and collected by issuers; acquirers pass the fees through to issuers; processors facilitate the transaction messaging. The IFPA covers both credit and debit cards, including general-use prepaid cards. It also applies to any “issuer” of such cards, any “payment card network,” any “acquirer bank” (the merchant's bank), and any “processor” involved in the transaction chain. Thus, every link in the payment chain is prohibited from “charging or receiving” interchange fees on the specified amounts.

The title and some of the act's wording refer to concepts that apply only to four-party cards (*i.e.*, cards that are issued by banks and operate over independent payment-card networks such as Visa and Mastercard), since technically only such cards entail the retention of an “interchange fee” by issuing banks. It is possible that the act was intended to also cover payments made using three-party cards (such as American Express and Discover), but national legislation currently in place to regulate interchange fees on debit cards applies only to four-party cards.³⁶

³⁴ *Id.* at §150-10(d)

³⁵ *Id.* at §150-10(a).

³⁶ See *Dodd-Frank Wall Street Reform and Consumer Protection Act*, H.R. 4173, 111th Cong. § 1075(a)(3) (2010), <https://www.congress.gov/bill/111th-congress/house-bill/4173>; Regulation II, *Debit Card Interchange Fees and Routing*, 76 FED. REG. 43,393, 43,475 (Jul. 20, 2011), <https://www.federalreserve.gov/aboutthefed/boardmeetings/frn-reg-ii-20231025.pdf>; Darry E. Getter, *Regulation of Debit Interchange Fees*, CONG. RSCH. SERVS. (2017), <https://www.congress.gov/crs-product/R41913>; Stacie E. McGinn & Mark Chorazak, *Debit Interchange Regulation: Another Battle or the End of the War?*, 2 HARVARD BUSINESS L. ONLINE 47 (2011), <https://web.archive.org/web/20250125015426/https://journals.law.harvard.edu/hblr/2011/07/debit-interchange-regulation-another-battle-or-the-end-of-the-war> (last visited Apr. 19, 2025).

It's worth noting that the IFPA was passed not as standalone legislation vetted in subject-matter committees, but as a rider within a larger state budget bill in 2024.³⁷ This procedural move expedited its passage, arguably without extensive deliberation of its complex implications.

C. A Gratuitous Anomaly

The IFPA excludes from interchange fees not only any sales taxes, but also gratuities. While the nominal argument for exempting sales tax is that such funds are remitted to the government, no such argument can be made for tips, which are voluntary payments that are generally passed on directly to service employees. Their processing cost is arguably comparable to that of the underlying sale. By extending the fee exemption to gratuities, Illinois is adopting a broader anti-fee stance than might be justified by the original policy rationale. Tips, unlike sales taxes, are not mandated by law or remitted to the government; they are voluntary payments from customers to service employees (or pooled by the merchant to distribute to staff).

Merchants were not previously able to recover the cost of collecting tips for staff. So, the exclusion of tips from interchange fees under the IFPA was clearly unrelated to the effect of Gov. Pritzker's proposed cap on the "retailer's discount." Rather, it seems to have been driven mainly by a desire to give restaurateurs an additional reason to support the legislation.

Proponents of the gratuity exclusion claim that merchants should not pay swipe fees on amounts they do not ultimately keep as profit: tips are passed through to employees. This, they argued, makes them similar to sales taxes.³⁸ From a legal perspective, however, collecting a tip is entirely optional and not a statutory duty (unlike collection of sales tax). A merchant could choose to accept only cash tips or refuse to accept tips entirely.

In practice, of course, most customers expect to be able to charge tips to their payment cards, and it is efficient to do so. The IFPA's extension of the fee prohibition to gratuities thus suggests that, in order to assuage an important interest group, the Illinois General Assembly was willing to go beyond the narrow "tax collection cost" justification and simply maximize merchant savings on any portion of a transaction that the merchant does not retain.

Allowing an interchange exemption for tips creates anomalies. For one, Illinois law continues to allow merchants to deduct the sales-tax collection allowance (albeit now capped) for remitting taxes, but there is no analogous state allowance or credit for processing tips. Nor would it make sense, as tips are not a government levy. By lumping gratuities into the IFPA, the General Assembly signaled

³⁷ See *Bill Status of HB4951*, 103rd Ill. Gen. Assembly, available at <https://www.ilga.gov/legislation/billstatus.asp?DocNum=4951&GAID=17&GA=103&DocTypeID=HB&LegID=152864&SessionID=112> (last visited Apr. 19, 2025).

³⁸ Howard W. Herndon, *The Complexities and Costs of Eliminating Interchange Fees on Sales Tax Portions*, Womble Bond Dick., (Jun. 14, 2024), <https://www.womblebond dickinson.com/us/insights/alerts/complexities-and-costs-eliminating-interchange-fees-sales-tax-portions>.

that the true aim was broader price controls on processing fees, not merely aligning fees with governmental functions. This casts doubt on the purported “principled fairness” argument, since the inclusion of tips makes the IFPA even more of a straightforward transfer from issuing banks (and, as discussed below, ultimately their customers) to merchants.

As noted, tip amounts should logically be treated as part of the service transaction with the customer. Paying interchange fees on tips that are included as part of a card transaction is thus part of the cost of doing business in a card-based economy, no different than paying interchange fees on the meal price itself. The IFPA’s contrary approach suggests a slippery slope: if taxes and tips merit special treatment because the merchant doesn’t keep them, one might ask, what about other pass-through charges?

For instance, if a merchant sells on consignment (not owning the goods), or collects government fees (like an auto-bureau fee), should those be interchange-fee exempt as well? Going further, merchants might argue that they should only pay interchange fees on the markup—the difference between the price for which goods are bought and the price at which they are sold—on grounds that they are merely acting as intermediaries between the producer or wholesaler and the consumer. That would, obviously, be ridiculous.

D. Is the IFPA a Trojan Horse?

On the aforementioned IRMA webpage titled “Swipe Fees,” the association states:

At the federal level, IRMA has partnered with U.S. Sen. Dick Durbin to advocate for passage of the Credit Card Competition Act. This bipartisan legislation would enhance competition and choice in the credit card network market, pushing fees down and providing relief for consumers and retailers alike.³⁹

U.S. Sen. Dick Durbin (D-Ill.) filed an *amicus* brief supporting Illinois in the ensuing litigation, claiming that the eponymous federal provision (the “Durbin amendment”) did not preempt states from going further to protect local merchants and consumers. Durbin and others argue that, if Congress won’t tackle credit-card fees (Durbin’s attempts to expand fee regulation have stalled in Congress), states should step in. The IFPA has therefore taken on a symbolic importance in the larger debate over interchange fees, raising the question: will this state-level innovation bring relief or chaos? For all the hubris about “fairness,” the more plausible explanation for the IFPA is that it is being used as a tool to attempt to force the payments industry to accept federal regulation.

E. Explaining the IFPA Conclusion

At one level, the IFPA represents a transfer of cost from Illinois taxpayers to card-issuing banks, which may no longer retain interchange fees on the tax and tip portions of a payment. Issuing banks must either absorb the processing cost for that portion without compensation or attempt to recoup it elsewhere. In effect, the IFPA would mandate a partial unbundling of the interchange fee: what

³⁹ Ill. Retail Merchs. Ass’n, *supra* note 27.

was once a single percentage applied to the full transaction is now bifurcated, with the tax and gratuity portion carved out as fee-free, from the merchant's perspective.

By eliminating interchange fees on taxes and tips, the IFPA effectively uses banks' revenue to subsidize large merchants. Moreover, the redistribution effected by this subsidy could be *larger* than the *de facto* subsidy that Illinois previously provided from its tax coffers via the retailer allowance. As explored in Section IV, this mandatory redistribution is partly extraterritorial, as it would be funded by out-of-state entities (large card-issuing banks headquartered elsewhere) and their customers.

In sum, the IFPA's design was driven by a mix of political compromise and merchant lobbying, rather than a coherent economic principle. Illinois' unusually large tax-collection discount was curtailed, and the elimination of interchange fees on taxes and tips was offered as a substitute balm for merchants. The next section evaluates whether the underlying premise—that sales-tax collection costs uniquely justify such measures—holds water, especially when comparing sales-tax obligations to other tax and regulatory burdens that businesses routinely bear without special fee exemptions.

III. The Sales-Tax Exception

Merchant groups claim that the collection of sales tax creates a substantial administrative burden that justifies states permitting merchants to deduct a portion of the sales tax or be granted a rebate to compensate for this cost.⁴⁰ Until recently, many states permitted merchant deductions or rebates on sales taxes precisely for that reason,⁴¹ but most states have since curtailed such practices.⁴²

In contrast to sales tax, few if any states allow businesses to deduct or otherwise receive compensation for the administrative costs of collecting and remitting other taxes. Nor does the federal government. Notably:

1. **Payroll Taxes:** Employers withhold and remit taxes on employee wages, but receive no direct subsidy or rebate for this service.⁴³

⁴⁰ Herndon, *supra* note 40

⁴¹ See *Sales Tax Rebates by State*, DAVO BY AVALARA, <https://www.davosalestax.com/sales-tax-rebates-by-states> (last visited Apr. 4, 2025).

⁴² *Comparison of State Retail Sales Tax Administrative Provisions*, FED. TAX ADM., <https://www.taxadmin.org> (last visited Apr. 2, 2025); JOHN MIKESSELL, *FISCAL ADMINISTRATION: ANALYSIS AND APPLICATIONS FOR THE PUBLIC SECTOR* (Cengage Learning, 9th ed., 2013).

⁴³ The IRS' guidance makes clear that, while an employer's share of payroll taxes (such as FICA taxes) is deductible as an ordinary and necessary business expense, no additional deduction or rebate is permitted for the expense of administering those payroll taxes. For example, IRS Publication 15 (Circular E, Employer's Tax Guide) explains that payroll-tax liabilities must be paid in full and that the costs incurred in collecting, calculating, and remitting these taxes are not eligible for a separate tax deduction or rebate beyond what is already allowed for the employer's tax expense. See *Guide to Business Expense Resources*, INTERN. REVENUE SERV., <https://www.irs.gov/forms-pubs/guide-to-business-expense-resources> (last visited Apr. 4, 2025).

2. **State Income Tax:** Businesses and individuals pay state income taxes in full, with no discount or reimbursement for the administrative tasks involved.⁴⁴
3. **Franchise Taxes:** These are generally fixed charges for the privilege of doing business in a state, not subject to any compensatory allowances for collection costs.⁴⁵
4. **Property Taxes:** The responsibility for paying property taxes lies squarely on the property owner, without any offset for collection or reporting costs.⁴⁶
5. **Excise Taxes:** Similar to sales taxes, excise taxes are collected at the point of sale but generally without any special deductions for the business.⁴⁷
6. **Business-License Taxes and Fees:** Typically collected in a lump sum without any deduction for the collection process.⁴⁸
7. **Federal Corporate-Income Taxes:** No deduction or rebate is offered for the administrative burden of remitting federal taxes.⁴⁹

Sales taxes are thus unique, in that many states historically provided a retailer a discount or rebate for collecting and remitting the tax.⁵⁰ Given that businesses are not now, nor have they ever been, permitted deductions or rebates from other taxes—including those collected and remitted by the business effectively on behalf of others, such as payroll taxes—it seems strange and even fundamentally unfair that businesses should be permitted to do so for sales tax.

Despite this anomaly, an argument in support of a specific deduction or rebate can be made from the perspective of administrative efficiency. Specifically, to the extent that the use of electronic (digital) systems to record and transmit sales taxes results in higher levels of compliance and reduces the

⁴⁴ In the United States, the costs a business incurs for administering its corporate-income tax are generally treated as ordinary and necessary business expenses. As such, the administrative costs associated with such taxes—such as fees paid for tax preparation, internal tax administration, or related professional services—are typically deductible. They reduce the taxable income reported on the corporation’s federal income-tax return, provided they meet the criteria under Section 162 of the Internal Revenue Code for ordinary and necessary business expenses. However, there is no separate mechanism to “rebate” these administrative costs. In other words, while a business can deduct them from its taxable income, it cannot claim them as a tax credit or receive a direct refund for them. (See IRS Publication 535, which outlines the rules for deducting business expenses, including those related to tax administration).

⁴⁵ *Franchise Taxes: A Tax for the Privilege of Existing Within a State*, LEXISNEXIS (Feb. 18, 2025), <https://www.lexisnexis.com/community/insights/legal/b/practical-guidance/posts/franchise-taxes-a-tax-for-the-privilege-of-existing-within-a-state>; Jerome R. Hellerstein *et al.*, *State Taxation* § 7.01 (3rd ed. 1998), <https://digitalcommons.law.uga.edu/books/126>.

⁴⁶ See 72 Am. Jur. 2d State and Local Taxation §§ 684, 687, 693 (2023 update).

⁴⁷ Antonio Del Cueto, *Do You Understand the Differences Between Sales Tax and Excise Tax?*, TAXFYLE (Mar. 5, 2025), <https://www.taxfyle.com/blog/differences-between-sales-tax-and-excise-tax>.

⁴⁸ See EUGENE MCQUILLIN, *THE LAW OF MUNICIPAL CORPORATIONS*, at 9, §§ 26:29-26:36 (3d ed. & Supp.).

⁴⁹ See BORIS I. BITTKER & JAMES S. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* (7th ed. & updates) (In addition, an examination of the relevant provisions of the federal code that govern corporate-income tax (e.g., 26 U.S.C. §§ 11, 6012–6151), there is no provision offering a “discount” or “rebate” for compliance costs. The prohibition on deducting federal income taxes themselves can be found in 26 U.S.C. § 275. While various credits exist for specific policy reasons (e.g., foreign tax credit, R&D credit, etc.), none is designed to compensate for the administrative burden of remitting corporate-income taxes.)

⁵⁰ See JOHN L. MIKESSELL, *FISCAL ADMINISTRATION: ANALYSIS AND APPLICATIONS FOR THE PUBLIC SECTOR* (9th ed.), <https://www.amazon.com/Fiscal-administration-Analysis-applications-public/dp/0256024529>.

costs of monitoring and enforcement by the state, it may be efficient to incentivize the use of such electronic systems.⁵¹ A deduction or rebate provides just such an incentive.

Nonetheless, from an economic perspective, it is inefficient to offer the same incentive on every transaction because there are substantial economies of scale in operating electronic systems that record and remit transactions.⁵² The amount therefore required to induce the use of electronic systems and maximize compliance likely falls rapidly as sales rise.

Studies that have looked at the costs of compliance support this conclusion. A 2006 study by PwC found that, across all retailers, the weighted average compliance cost of collecting and remitting sales tax was about 3% of the tax collected.⁵³ These costs were, however, disproportionately higher for small businesses than for larger firms: businesses with less than \$1 million in annual sales incurred compliance costs averaging about 13.5% of the sales tax they collected, while those with \$1–10 million in sales had average costs of about 5.2%, and those over \$10 million faced average costs of about 2.2%.⁵⁴ In other words, the smallest merchants spent roughly six times more, relative to the amount of tax collected, than the largest retailers.

Over time, these administrative costs have fallen dramatically. Data from the Federal Reserve suggest that the overhead for electronic transactions is minimal compared to the manual-processing costs that dominated the mid-20th century.⁵⁵ Thus, while a modest retailer discount may have been justified decades ago, the much lower costs now attendant to collecting and remitting sales taxes—especially for larger, more technologically sophisticated retailers—call into question the basic premise of the IFPA.

Moreover, as the costs of administration have fallen, most states have since curtailed or capped this benefit.⁵⁶ In most states, the administrative burden of tax compliance is now integrated into the general cost of doing business, rather than subsidized through a dedicated allowance.⁵⁷

⁵¹ Morris, *supra* note 3, at 12-13

⁵² Many compliance tasks—such as filing returns or keeping abreast of tax-law changes—have a fixed element that does not scale down with a company's size or sales volume. As a result, smaller retailers spend a greater percentage of their resources to fulfill tax obligations.

⁵³ See *Retail Sales Tax Compliance Costs: A National Estimate*, NAT'L ECON. CONSULTING (Apr. 7, 2006), <https://netchoice.org/wp-content/uploads/2020/03/cost-of-collection-study-sstp.pdf#:~:text=The%20top%20three%20sales%20tax,training%20of%20personnel%20on%20sales>.

⁵⁴ *Id.* at E-2.

⁵⁵ See Bruce Donald *et al.*, *To Tax or not to Tax? The Case of Electronic Commerce*, 21 (1) CONTEMP. ECON. POL'Y 25-40 (2003), <https://www.proquest.com/docview/274262391>; *id.*; Mikesell, *supra* note 51.

⁵⁶ Gail Cole, *Vendor Discounts for Filing Sales Tax on Time, A State-by-State Guide*, AVALARA (Dec. 30, 2024), <https://www.avalara.com/blog/en/north-america/2021/10/vendor-discounts-for-filing-sales-tax-on-time.html>.

⁵⁷ Federation of Tax Administrators, *supra* note 42; Illinois General Assembly, *supra* note 37; DAVID BRUNORI, *STATE TAX POLICY: A POLITICAL PERSPECTIVE* (5th ed.). <https://rowman.com/ISBN/9781538173312/State-Tax-Policy-A-Primer-Fifth-Edition>.

While there are legitimate reasons to provide a small incentive for electronic collection and remittance of sales taxes, the magnitude of Illinois' traditional uncapped retailer discount likely far exceeded any reasonable estimate of actual administrative cost for larger merchants. The IFPA does not contribute toward efficient tax compliance, since that is achieved by the remaining capped retailers' discount. Instead, it primarily distorts the cost distribution within the payment system.

IV. Extraterritorial Effects of the IFPA

The IFPA's reach extends well beyond Illinois' borders. Since the vast majority of credit- and debit-card issuers are headquartered or chartered in other states—or even outside the United States—the act would compel these institutions to adjust their fee structures for transactions occurring in Illinois.⁵⁸ An Illinois merchant's credit-card transaction processed by a national bank must now exclude interchange on the sales tax and gratuity portions, regardless where the issuer is based. Broadly, these effects can be divided into two classes: compliance costs and revenue reduction.

A. Compliance Costs

Issuers and card networks will face significant costs upgrading their information-technology systems and transaction-processing software to comply with the IFPA's data requirements. This includes modifications to authorization systems to identify sales tax and tip components, and to implement new rebate or tracking mechanisms for post-transaction adjustments.⁵⁹

Implementing the IFPA would not be as simple as flipping a switch to “no fees on taxes and tips.” It would require significant, system-wide changes to the nation's electronic-payments infrastructure. Payment-card networks and processors would have to adjust the format of messages and the algorithms that calculate interchange fees for “Illinois” transactions. This entails, at minimum:

- Reliably identifying when a transaction involves Illinois sales tax and/or gratuity, and the exact amounts thereof, many of which vary by type of good and/or location within the state;
- Modifying authorization and settlement-message formats to carry this information;
- Altering the clearing and settlement systems to ensure interchange fees are computed only on the permitted base amount and zeroed out on the tax/tip portions; and
- For merchants relying on the ability to recoup the sales tax and tip component of interchange fees after the fact, maintaining records of transactions for the purposes of confirming or disputing the amounts claimed.

Each of these steps raises technical and coordination challenges:

⁵⁸ *Large Commercial Banks*, FED. RESERVE STAT. RELEASE (Dec. 31, 2024), <https://www.federalreserve.gov/releases/lbr/current>; Paul Calem & Benjamin Gross, *The Credit Card Market Is Not Even Close to Being Overly Concentrated*, BANK POL'Y INST. (Apr. 18, 2024), available at <https://bpi.com/wp-content/uploads/2024/04/The-Credit-Card-Market-is-Not-Even-Close-to-Being-Overly-Concentrated.pdf> (The largest of these is BMO Bank, a subsidiary of a Canadian bank, which has about 0.1% of U.S. market share in outstanding credit-card balances).

⁵⁹ Morris, *supra* note 3, at 19.

I. Transaction-data requirements

As noted, merchants wishing to exclude interchange fees on taxes and tips at the source (rather than recouping them later) must send tax and gratuity data with the transaction. To our knowledge, no point-of-sale (POS) system is currently programmed to separate data in the authorization message precisely in the way that would be required by the IFPA. While many electronic cash registers can produce an itemized receipt, transmitting an itemization through the payment network is another matter.

Standard consumer-card transactions involve the transmission of “Level 1” data, which typically contain essential information required to authorize a payment, including:

- **Cardholder Data:** PAN (primary account number), card expiration date.
- **Transaction Amount:** The total amount requested for authorization.
- **Merchant Data:** Basic merchant information, such as the identifier or name.
- **Authorization Request:** Whether the transaction should be approved or denied based on available funds or credit limits.

Most payment networks also *permit* additional information to be sent via “Level 2” and “Level 3” data. Level 2 data provide information typically used in business-to-businesses (B2B) corporate-card transactions, primarily to help businesses better track and manage their expenses. This can include:

- Invoice number;
- Sales tax;
- More detailed data about the merchant, such as location or merchant category code (MCC); and
- Details regarding what the transaction was for (goods/services).

Level 3 data provide even more detailed information, also primarily for B2B corporate-card purchases, including:

- Line-item details (e.g., description, quantity, unit price, and total price);
- Freight or shipping costs;
- Any discounts applied to the transaction;
- Any other tax amounts that need to be itemized;
- Shipping or delivery information for physical goods; and
- Enhanced merchant details, such as DUNS (Data Universal Numbering System) numbers.

In principle, Level 2 and Level 3 data could be used to communicate sales tax (a Level 2 item), other taxes, such as excise, and other items, such as gratuities (both Level 3 items). This would, however, amount to a change in the way the messaging system functions. As such, it would entail considerable reprogramming by all parties in the payment stack (merchants, gateways, acquirers, other processors, networks, issuers). This would inevitably result in an increase in cost for those parties.

Visa and Mastercard standards do support some tax indicators in transaction data (as Level 2 or Level 3 data) on corporate-card transactions, but there is no standard for the separate recording of

tips. Adding an indicator for tips and extending the recording of tax indicators to all consumer transactions at every Illinois merchant would require entirely reprogramming the systems.

Many small businesses would need to upgrade not only software but POS equipment. Payment processors would likely need to assist their merchant clients in this transition—an administrative burden that would be magnified to the extent that merchants are unfamiliar with how the technology works. Acquiring banks would also have to reprogram their systems to accommodate the new data in the messages.

Smaller merchants will almost certainly face disproportionate costs. A study by the U.S. Government Accountability Office has found that, following the *Wayfair* decision—which effectively required internet retailers to remit sales tax to the state in which a product is delivered—smaller businesses faced disproportionate costs of compliance.⁶⁰ Whereas large businesses only needed to adjust or slightly expand their systems for new jurisdictions, incurring minimal new setup costs, most small businesses were often starting from scratch.

For example, one medium-sized retailer with approximately \$20 million in annual revenue told GAO it spent about \$8,000 to purchase tax software and \$43,000 to integrate it with existing systems.⁶¹ Another business with \$42 million in sales spent roughly \$200,000 on software integration to comply with multi-state tax rules.⁶² By contrast, one smaller business spent \$1,500 per month on compliance services to remit only about \$500 in tax, effectively triple the cost relative to the revenue collected for the state. Another small online seller calculated that it spent about \$2.25 in compliance costs for every \$1 in sales tax collected over a multi-year period, across dozens of states.

Large retailers do not face such lopsided ratios; their high sales volumes mean the taxes collected far exceed compliance expenditures.

2. *Network and issuer-system modifications*

On the receiving end, card issuers' systems (and/or their processors) would have to be reconfigured to manage a new interchange-calculation rule specific to Illinois tax/tip amounts. The interchange fee has traditionally been a simple percentage applied to the total transaction amount (plus a fixed fee, in some cases). Under the IFPA, the issuer's system would have to subtract certain components. To the extent that networks determine the amount of interchange fee to be deducted (based on the type of card, etc.), the networks must implement state-specific logic.

Because interchange fees are normally uniform nationwide for a given card product, adding a jurisdiction-specific rule increases complexity. Every transaction would need to be checked: Does it

⁶⁰ See *Remote Sales Tax: Federal Legislation Could Resolve Some Uncertainties and Improve Overall System*, U.S. GOV'T ACCOUNTABILITY OFF. (GAO-23-105359, Nov. 14, 2022), available at <https://www.gao.gov/assets/gao-23-105359.pdf>.

⁶¹ *Id.* at 24.

⁶² *Id.*

involve an Illinois tax or tip? If yes, apply different math. This adds processing overhead to every single transaction in the nation.

In 2024, Visa and Mastercard processed between 130 and 150 billion transactions in the United States.⁶³ If the IFPA were implemented, every one of these transactions would now be subject to an additional step in order to segment the 5-8 billion Illinois-related transactions. These costs are essentially fixed overhead, which, ultimately, will be borne by market participants broadly. They would likely be passed on in the form of slightly higher network fees or merchant-service fees and/or lower overall efficiencies. It is telling that the federal Office of the Comptroller of the Currency (OCC), in an *amicus curiae* brief opposing the IFPA, observed:

Credit and debit card transactions help to propel the Nation's economy by facilitating commerce. The interchange fees that financial institutions collect to facilitate these transactions are a core feature of an intricately-designed Nation-wide payments system in which national banks and Federal savings associations play an essential role. The Illinois Interchange Fee Prohibition Act, H.B. 4951, Section 150 ("IFPA") is an ill-conceived, highly unusual, and largely unworkable state law that threatens to fragment and disrupt this efficient and effective system. Although the IFPA's requirements are vague and ambiguous in many respects, this much is clear: the IFPA prevents or significantly interferes with federally-authorized banking powers that are fundamental to safe and sound banking and disrupts core functionalities that drive the Nation's economy. In short, the IFPA constitutes both bad policy and an unlawful interference with federally granted powers.⁶⁴

To reiterate, the "global" nature of card networks means that even out-of-state issuers and many payment intermediaries would have to adjust their systems because of one state's law, an inefficiency that multiplies costs across the economy. The IFPA would essentially compel the industry to build a new capability—parsing and zero-rating certain components. In a seamless national payments network, that is a non-trivial ask.

3. Rebate trouble

As noted above, merchants who are unable to report the amount of taxes and tips related to a transaction in real-time—e.g., because their existing POS system is incapable of reporting Level 2/3 transactions and they choose not to incur the substantial cost of upgrading their system—may avail themselves of §150-10(b) of the IFPA.

But therein lies a paradox: if the merchants are not reporting the tax and tip amount, there will be no record of those amounts in the electronic-payments system. Neither the processor, nor the

⁶³ See *Visa Annual Report 2024*, VISA (2024), available at https://s29.q4cdn.com/385744025/files/doc_downloads/2024/Visa-Fiscal-2024-Annual-Report.pdf.

⁶⁴ *Amicus Curiae of the Office of the Comptroller in Support to Plaintiff's Motion for a Preliminary Injunction, Illinois Bankers Association et al v. Kwame Raoul*, Case No. 1:24-cv-07307 (Oct. 4, 2024), available at <https://www.occ.gov/topics/laws-and-regulations/litigation/amicus-curiae-brief-illinois-bankers-assoc-v-raoul.pdf>.

acquirer, nor the network, nor the issuer will know what those excluded amounts should have been. As such, issuers will presumably have to set aside some arbitrary amount for up to 210 days following a transaction to cover rebate requests.

Meanwhile, to address potential disputes (see below), acquirers and issuers will also need to retain data on every transaction from every merchant not reporting tax and tip amounts through the new automated-reporting mechanism for at least 210 days. They will also have to implement regular audits to ensure that amounts classified as “gratuities” are, indeed, gratuities. This alone would be enormously costly.

4. *Error-handling and dispute process*

With new data and complex rules, errors are inevitable. Suppose a merchant forgets to flag the tax amount; the issuer retains interchange on the full amount; and the merchant later submits documentation under §150-10(b) to reclaim that fee. That introduces a new quasi-dispute process: merchants claiming back improper fees. Networks or acquirers will have to manage these claims, verify documents, and arrange reimbursements—a process akin to handling chargebacks or billing disputes. This is an additional transaction cost injected into the system. For busy merchants, the administrative hassle might not be worth a small refund, meaning that some may not bother (leading to uneven implementation).

B. Reduced Revenue and Responses by Issuers

While compliance costs will likely be significant, much more significant will be the effects on revenue to issuing banks from interchange fees, which in turn funds consumer rewards and supports the overall cost structure of card issuance. Removing interchange fees on the sales tax and gratuity portions means that, on average, banks could lose about 0.1% of the revenue on each transaction involving Illinois merchants.⁶⁵ For large issuers, that could translate into tens of millions of dollars annually.⁶⁶ Issuers, both in-state and out-of-state, are likely to respond to these revenue losses in one or more of several ways.

1. *Reducing cardholder rewards and benefits*

Credit-card issuers fund rewards primarily with interchange fees. If interchange-fee revenue from Illinois transactions falls by 10% or more, banks will be less able to cover extant rewards commitments. Wherever governments have imposed price controls on interchange fees—including in the

⁶⁵ See *Taxes in Illinois*, TAX. FOUND., <https://taxfoundation.org/location/illinois> (last visited Apr. 20, 2025) (The Tax Foundation estimates that the average sales tax in the state is 8.86%. If gratuities are made on about 7% of those sales at a rate of 15%, that takes the total up to about 10% of the sale, on average. Assuming interchange fees of 1%, the total loss is 0.1% of the sale amount).

⁶⁶ According to the U.S. Census Bureau, Illinois retail sales were around \$244 billion in 2022. See *QuickFacts: Illinois*, U.S. CENSUS BUR., <https://www.census.gov/quickfacts/fact/table/IL/PST045223> (last visited Apr. 4, 2019). Assuming modest growth gives at least \$250 billion this year, interchange-fee revenue from sales tax and gratuities might account for about \$250 million. For issuers with market share of 4% or more, that is at least \$10 million.

United States following the Durbin amendment; in Australia following the Reserve Bank of Australia's price controls on interchange fees; and in the EU following the Interchange Fee Regulation—at least some issuers (and, in many cases, the vast majority) have responded by reducing the generosity of rewards programs.⁶⁷

Banks may also cut other cardholder benefits that are currently funded by interchange fees, such as travel insurance and purchase protections, to make up some of the lost revenue, as was done in Australia and Europe following the interchange-fee price controls in those jurisdictions.⁶⁸ As with rewards, such an approach is less likely if Illinois remains the only state to impose differential interchange-fee price controls (except perhaps for local banks and credit unions, whose customers are predominantly or exclusively Illinois residents). In that case, as with rewards, out-of-state cardholders of national banks would be subsidizing the Illinois operations of big-box merchants.

In principle, issuers could offset these losses by creating state-specific Illinois rewards policies, but this would entail amending nearly every cardholder agreement, as well as agreements with rewards partners (e.g., airlines and hotels). It could also create communications challenges for issuers and add to the complexity of the transaction process.

Alternatively, issuers could offset the lost revenue by adjusting their overall rewards programs to be slightly less generous across the board. A bank might drop a cashback rate from 2% to 1.95%, for example, or devalue points by a similar proportion for all cardholders. This would also entail amendments to most cardholder and many partner agreements. But by spreading the pain more widely, it might be less challenging to communicate.

Meanwhile, widespread application would make administration more straightforward. If this option were chosen, however, Illinois' policy would have imposed a negative externality on cardholders across the nation, with out-of-state cardholders effectively being forced to subsidize the Illinois operations of big-box merchants even if they make no purchases in Illinois.

The likelihood of issuers adjusting rewards would increase if multiple states were to pass similar legislation. Even if Illinois remains unique, issuers still may scale back benefits offered to Illinois-based customers or for transaction categories heavily composed of tax (e.g., gas purchases that include fuel excise taxes).

2. *Introducing or increasing annual fees*

In some cases, issuers have responded to price controls on interchange fees by introducing or increasing annual fees on credit cards. Most notably, Australian banks increased average annual fees

⁶⁷ See Todd J. Zywicki et al., *The Effects of Price Controls on Payment-Card Interchange Fees: A Review and Update*, INT'L CTR. L. & ECON. (Mar. 2, 2022), <https://laweconcenter.org/resources/the-effects-of-price-controls-on-payment-card-interchange-fees-a-review-and-update>.

⁶⁸ *Id.*; Iris Chan et al., *The Personal Credit Card Market in Australia: Pricing Over the Past Decade*, RSRV. BANK OF AUSTL. (2012), available at <https://www.rba.gov.au/publications/bulletin/2012/mar/pdf/bu-0312-7.pdf>.

by around 50%.⁶⁹ It seems likely that some banks would do the same for Illinois cardholders, who might find previously no-fee credit cards now carry a \$20 annual fee, for instance. Meanwhile, Illinois residents with more generous rewards cards might see their annual fees rise by \$50.

Debit cards, or the current accounts with which they are associated, could also see new or increased fees. This was precisely what happened following the Durbin amendment. Initially, some covered banks threatened to introduce monthly debit-card usage fees in response to the price controls on interchange fees. But following a public outcry, they sought to recoup lost revenue in other ways, with many banks increasing monthly fees and raising the minimum deposits required for free checking accounts.⁷⁰

Given the large proportion of debit and credit cards issued by nationally chartered banks and non-Illinois based banks and credit unions, it seems likely that such an approach to the recoupment of losses resulting from the IFPA's price controls on interchange fees in Illinois would represent a significant extraterritorial effect. This would be magnified to the extent that banks and credit unions apply these changes to non-Illinois-based customers.

3. *Higher interest rates*

Credit issuers might also look to the credit-term side, possibly raising their annual percentage rates (APRs). Following the introduction of the IFR, the delta between the European Central Bank's base rate and the APR on credit cards rose.⁷¹

While the IFPA by itself might not cause a measurable APR hike, the cumulative pressure of any revenue loss could contribute to upward pressure on interest rates, especially for riskier borrowers. Any such changes would, again, mean that consumers pay more. And to the extent that such changes are applied to customers outside Illinois, the effect would be extraterritorial.

4. *Fragmentation of the multilateral interchange-fee system*

Card networks currently operate under a uniform multilateral interchange-fee schedule that applies nationwide. If other states copy Illinois and introduce their own state-specific mandates, carving out interchange fees for sales tax (and possibly other elements, such as gratuities), networks would likely be forced to develop multiple fee regimes, thereby increasing complexity, compliance costs, and

⁶⁹ See GAO Suggests Federal Solution for Remote Sales Tax, *supra* note 61; Zywicki et al., *supra* note 67.

⁷⁰ Todd J. Zywicki et al., *Unreasonable and Disproportionate: How the Durbin Amendment Harms Poorer Americans and Small Businesses*, INT'L CTR. L. & ECON. (Apr. 25, 2017), <https://laweconcenter.org/resources/unreasonable-and-disproportionate-how-the-durbin-amendment-harms-poorer-americans-and-small-businesses>; Todd J. Zywicki et al., *Price Controls on Payment Card Interchange Fees: The U.S. Experience* (Geo. Mason L. & Econ. Rsch. Working Paper No. 14-18, 2014), https://www.law.gmu.edu/pubs/papers/14_18.

⁷¹ See Julian Morris, *The Credit Card Competition Act's Potential Effects on Airline Co-Branded Cards, Airlines, and Consumers*, INT'L CTR. L. & ECON. (Nov. 17, 2023), <https://laweconcenter.org/resources/the-credit-card-competition-acts-potential-effects-on-airline-co-branded-cards-airlines-and-consumers>.

operational inefficiencies. The larger the number of states that follow this approach, the more fragmented the interchange system would become, potentially making it unworkable.

5. *Inequitable competitive effects*

The preliminary injunction in *Illinois Bankers Ass'n v. Raoul* applies to national banks regulated under the National Bank Act (NBA) and the Home Owners' Loan Act (HOLA) due to federal preemption.⁷² The court later extended the preliminary injunction to out-of-state state banks, as well, under similar preemption principles.⁷³ Despite this, banks chartered in Illinois (as well as federal credit unions) remain subject to the IFPA. If this is upheld, an uneven playing field will develop, distorting competition unnaturally in favor of national and out-of-state banks.

6. *Adjusting default multilateral interchange fees*

Finally, card networks might attempt to compensate for the revenue loss in Illinois by adjusting the default multilateral interchange-fee schedules that apply across the United States. Such adjustments, which would likely be across-the-board increases, would represent a transfer from out-of-state merchants and consumers to Illinois-based merchants.

C. **Extraterritorial Effects Conclusion**

The Illinois Bankers Association argues that the compliance costs for reprogramming systems to accommodate the IFPA could run into hundreds of millions of dollars for banks and networks alone.⁷⁴ Meanwhile, issuing banks would experience shortfalls in interchange-fee revenue from transactions in Illinois. In response, banks would likely be forced to compensate either by reducing cardholder benefits or increasing fees.

These compensatory actions would likely affect all cardholders, with the result that most of those affected would be cardholders living outside Illinois. Reduced rewards and increased fees would diminish the attractiveness of card use, leading to lower consumer spending and therefore harming merchants, as well.⁷⁵ There would thus be harmful extraterritorial effects across the value chain. While banks, payment processors, and networks would suffer concentrated costs and losses, these would be passed on to consumers and merchants.

⁷² IBA I.

⁷³ IBA II.

⁷⁴ IBA I, at 6 (“Illinois Bankers has presented sufficient evidence to establish irreparable harm. The alleged compliance would likely be more crippling for some Illinois financial institutions than the State claims. Illinois Bankers submitted declarations, in which financial institutions and business owners claim that the money they would have to spend to come into compliance with the IFPA would be so devastating to their business that it may drive them from the market altogether... Likewise, leadership from the American Bankers Association, which represents over 1,100 branches in Illinois, explained that some of their members would likely cease providing credit and debit card services and no longer be able to serve as Acquiring banks to merchants.”).

⁷⁵ Morris & Sperry, *supra* note 7 (This is because card use increases both spending and throughput).

If the courts deem that the IFPA does not apply to nationally chartered banks (per the preliminary injunction), then these extraterritorial effects would be muted, but the resultant competitive distortions would be significant.

V. Legal Arguments Against the IFPA

In light of the effects of the IFPA on banks, savings institutions, credit unions, and card networks, it is no surprise that the law has been challenged in court. In August 2024, the Illinois Bankers Association, along with several other bank and credit-union groups, brought a constitutional challenge against the IFPA, alleging the statute is preempted by various federal laws.⁷⁶

Each set of plaintiffs in the case was able to assert a relevant federal law or constitutional principle the IFPA violated. Nationally chartered banks pointed to the National Banking Act (NBA) and various federal regulations that apply specifically to them. Federal savings associations looked to the Home Owners' Loan Act (HOLA), which similarly empowers and regulates them. Federal credit unions asserted preemption under the Federal Credit Union Act (FCUA), because it gives the National Credit Union Administration the exclusive authority to regulate them. State banks chartered in Illinois pointed to state laws that give banks the same powers as nationally chartered banks. Out-of-state banks brought both Dormant Commerce Clause and federal law claims that they have the right to be treated similarly to in-state banks and nationally chartered banks, respectively.

In an *amicus* brief, one of the card networks (Mastercard) argued that the law would be unworkable in practice, not least due to the “extraordinary limitations” it places on processing card-transaction data:⁷⁷

Specifically, the Act makes it unlawful for “[a]n entity, other than the merchant” involved in a transaction to “distribute, exchange, transfer, disseminate, or use” the associated data “except to facilitate or process the electronic payment transaction or as required by law” (the “Data Usage Limitation”). 815 ILCS 151/150-15(b). Under the statute’s plain terms, for example, participants in the system could not use aggregated transaction data to detect fraud or administer rewards programs.⁷⁸

And concluding that:

The Data Usage Limitation would impose similarly overwhelming operational challenges. Banks and other financial institutions use transaction data for an array of key purposes including— but far from limited to—preventing fraud, administering rewards programs, and determining credit limits. Arbitrarily restricting such data’s use will make

⁷⁶ See IBA I.

⁷⁷ See IBA I.

⁷⁸ *Id.* at 2.

many of these activities economically or operationally infeasible, to the detriment of consumers, merchants, and financial institutions alike.⁷⁹

The U.S. District Court for the Northern District of Illinois considered these claims in a motion for preliminary injunction. On Dec. 20, 2024, the court granted the preliminary injunction in part against the IFPA, finding there was a likelihood the plaintiffs would succeed on the merits as to the NBA and HOLA claims,⁸⁰ but dismissed the state-law claims due to sovereign immunity not being waived by Illinois.⁸¹ The court did not accept that any federal law preempted the IFPA as to credit-card networks. This effectively meant that IFPA could not be enforced against nationally chartered banks or savings associations, but could be enforced against state-chartered banks and credit-card networks. After more briefing, the court decided Feb. 2 that the federal-credit-union plaintiffs did not establish that the FCUA preempted the IFPA, but that 12 U.S.C. §1831a(j) did preempt the IFPA as to out-of-state state banks.⁸²

Below, we will consider these arguments in more detail and consider the likely effects if the court's preliminary-injunction analysis holds as to the underlying merits.

A. Federal Preemption: The National Bank Act and Other Federal Laws

The IFPA faces a direct federal preemption challenge due to the national laws that establish federal banks, savings institutions, and credit unions. The crux is whether Illinois' attempt to regulate interchange fees is preempted by federal banking laws that grant national banks (and other federally chartered institutions) certain powers free from state interference. This subsection analyzes the preemption argument, focusing on the NBA and related regulatory doctrine, as well as considering whether any provisions of the Dodd-Frank Act or other federal statutes explicitly or implicitly preclude state-level interchange regulation.

I. NBA and HOLA preemption principles

The NBA, originally enacted in 1864 and now codified in Title 12 of the U.S. Code, provides that national banks (those chartered under federal law) have authority to exercise "all such incidental powers as shall be necessary to carry on the business of banking."⁸³ Over many decades, courts have interpreted this provision to mean that national banks have broad discretion in conducting banking activities (such as lending, taking deposits, and charging fees) and that state laws may not significantly

⁷⁹ *Id.* at 4.

⁸⁰ See *Federal Court Partially Grants Preliminary Injunction in Illinois Interchange Fee Lawsuit*, AM. BANKERS ASS'N (Jan. 3, 2025), <https://bankingjournal.aba.com/2025/01/federal-court-partially-grants-preliminary-injunction-in-illinois-interchange-fee-lawsuit>.

⁸¹ *Id.* at 37 (dismissing the state-law claims of the Illinois state banks, arguing that state law gave them the same powers as nationally chartered banks).

⁸² See IBA II.

⁸³ 12 U.S.C. § 24(Seventh).

impair or interfere with those authorized powers. In *Barnett Bank of Marion County, N.A. v. Nelson*, the Supreme Court held that state laws are preempted if they “prevent or significantly interfere with the exercise of a national bank’s powers.”⁸⁴ This “significant interference” test remains the benchmark for NBA preemption, reaffirmed by the Court as recently as 2024’s *Cantero v. Bank of America*.⁸⁵

This is different than normal conflict preemption, which requires a showing that an entity can’t comply with both sets of laws. Instead, it only requires a showing of significant interference with their ability to exercise their powers under national law.

Credit-card issuance and processing is unquestionably part of the “business of banking”; it involves lending (extending credit), payment services, and charging fees for those services. National banks engage in issuing credit and debit cards under their incidental powers, and they earn revenue through interest and fees (including interchange fees on card transactions). The OCC, which administers the NBA, has long promulgated regulations clarifying that national banks may charge non-interest fees, and that state attempts to regulate such fees are generally preempted.⁸⁶

For example, 12 C.F.R. § 7.4002 explicitly addresses “National bank charges” (such as service fees) and indicates that banks may set those charges per their business judgment, subject to safety and soundness, not state-law limitations.⁸⁷ Likewise, 12 C.F.R. § 7.4008 deals with lending by national banks and preempts state laws that obstruct or condition federally authorized lending powers—specifically listing state restrictions on terms of credit, including loan-related fees, as usually preempted.⁸⁸

While interchange fees are paid by merchants, rather than borrowers, interchange can be seen as part of the overall “terms of credit card services” offered by banks. Indeed, the OCC’s “Handbook on Credit Card Lending” explicitly lists interchange fees as part of the revenue structure of card programs,⁸⁹ signaling the OCC’s view that interchange is within the realm of bank charges protected by federal authority.

Against this backdrop, the IFPA’s interference is clear: it forbids national banks from collecting a category of fees they would otherwise collect in the normal course of offering card services. This is arguably a direct interference with a national bank’s power to set fees for its services. Just as states cannot cap the interest rate or annual fee a national bank charges on a credit card (national banks famously can “export” their home-state interest rates to other states, immune from those other states’

⁸⁴ *Barnett Bank of Marion Cty., N.A. v. Nelson*, 517 U.S. 25, 33 (1996).

⁸⁵ *Id.* at 33 (“[T]he National Bank Act preempts a state law ‘only if’ the state law... ‘prevents or significantly interferes with the exercise by the national bank of its powers’”); *Cantero v. Bank of America, N.A.*, 602 U.S. 205, 213-14 (2024).

⁸⁶ See IBA I at 18 (discussing OCC regulations and interpretive letters).

⁸⁷ 12 C.F.R. § 7.4002(b)(2).

⁸⁸ 12 C.F.R. § 7.4008.

⁸⁹ *Credit Card Lending*, OFF. COMPTROL. CURR. (2021), at 59, available at <https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/credit-card-lending/pub-ch-credit-card.pdf>.

usury laws, per *Marquette Nat'l Bank v. First of Omaha*⁹⁰), likewise a state should not be able to cap the interchange fees a national bank earns through its card-network participation.

While interchange fees are not charged to the bank's customer, they are income arising from the bank's service—functionally, a part of the pricing of the payment service the bank provides. By stripping out a portion of that pricing (on taxes/tips), Illinois is “preventing or significantly interfering” with the bank's revenue model in the card business.

The banks challenging the IFPA have made this case, and early indications are that courts find it persuasive. In October 2024, Judge Virginia Kendall granted a preliminary injunction preventing Illinois from enforcing the IFPA against national banks and federal savings associations, on the basis that those plaintiffs had shown a likelihood of success on their claim that the law is preempted by federal law (the NBA in the case of national banks, and HOLA in the case of federal savings associations).⁹¹ The court noted that federally chartered banks' ability to charge and receive interchange fees is an aspect of their federally authorized powers, and Illinois' law stands as an obstacle to the exercise of those powers.⁹² This is a straightforward application of the *Barnett Bank* standard; the IFPA substantially interferes by banning a category of fees that form a not-insignificant part of the banks' compensation for card services.

Illinois,⁹³ backed by Sen. Durbin in his *amicus* brief,⁹⁴ countered that the Durbin amendment's silence on credit-card fees implies no federal occupation of the field, and that states have historically been allowed to protect consumers and businesses via consumer-protection regulations, absent a direct conflict with federal law. They emphasized that preemption is only appropriate when a state law interferes with a national bank's exercise of its power to an “extreme degree.”⁹⁵ Illinois argued that the “meager limitation” on interchange fees posed by the IFPA were simply not sufficient to significantly interfere with the national banks' powers to collect interchange fees in general.⁹⁶

But given the evidence that compliance with the IFPA will require significant operational changes and will cost banks revenue (harming their card programs), the “significance” threshold seems crossed. It's comparable to a state law that would say, for instance: “Banks may not charge late payment fees on credit cards for customers within our state.” That would clearly cut off a source of

⁹⁰ *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978).

⁹¹ IBA I at 8-12

⁹² *Id.* at 9-10

⁹³ See Amicus Curiae of the Office of the Comptroller in Support to Plaintiff's Motion for a Preliminary Injunction, *Illinois Bankers Association et al v. Kwame Raoul*, Case No. 1:24-cv-07307 (Oct. 4, 2024), available at <https://storage.courtlistener.com/recap/gov.uscourts.ilnd.463030/gov.uscourts.ilnd.463030.76.0.pdf>.

⁹⁴ See Amicus Curiae of Senator Richard J. Durbin's Memorandum of Law in Opposition to Plaintiff's Motion for a Preliminary Injunction, *Illinois Bankers Association et al v. Kwame Raoul*, Case No. 1:24-cv-07307 (Oct. 4, 2024), available at https://www.durbin.senate.gov/imo/media/doc/durbin_files_amicus_brief_in_support_of_illinois_interchange_fee_prohibition_act.pdf.

⁹⁵ OCC Amicus Brief, *supra* note 93, at 23.

⁹⁶ *Id.* at 25-26.

revenue and alter a term of credit. Such a law would almost certainly be preempted by the NBA, especially after *Smiley v. Citibank*, where the Supreme Court upheld the OCC's view that late fees counted as "interest" and thus states couldn't cap them for national bank cards.⁹⁷ IFPA might not regulate "interest," but from the perspective of bank operations, it is regulating a fee related to extending credit.

Furthermore, the OCC itself took the unusual step of submitting an *amicus* brief on behalf of the nationally chartered banks in this case.⁹⁸ The OCC's involvement signals that the chief regulator of national banks sees a serious preemption issue; the OCC described the IFPA as conflicting with federal policy and burdening national banks.

The district court also found that the same preemption analysis from the NBA applies to federal savings associations under HOLA, as HOLA directs courts to apply "the laws and legal standards applicable to national banks" in determining whether federal law preempts state regulation of federal savings associations.⁹⁹ Federal savings associations are established under HOLA and regulated by federal law much like nationally chartered banks are established under NBA and regulated by federal law.

2. *The Durbin amendment*

The Electronic Fund Transfer Act (EFTA) creates a federal framework for electronic funds transfers, including those undertaken using debit cards.¹⁰⁰ Under the Durbin amendment, the EFTA regulates debit-card interchange fees and routing, which implies that Congress intended for a uniform national standard, at least with respect to debit cards.¹⁰¹ While the specific standard promulgated under the Durbin amendment almost certainly caused more harm than good, the basic idea of a uniform federal framework is not itself inherently bad (and, indeed, even the Durbin amendment would have been less harmful under different interpretations by the Federal Reserve).¹⁰²

Another argument made by the plaintiffs is that the IFPA, by imposing a state-specific mandate that sets interchange fees at \$0 for a component of debit transactions undertaken in Illinois, conflicts with this uniform federal mandate. This arguably affects all parties to such transactions, including the card networks. It is noteworthy that, while the Federal Reserve has, under the auspices of the Durbin amendment, imposed aggressive and harmful restrictions on the debit-card interchange fees that covered banks are permitted to retain, at no time has it publicly contemplated introducing

⁹⁷ See *Smiley v. Citibank (S.D.), N. A.*, 517 U.S. 735 (1996).

⁹⁸ OCC Amicus Brief, *supra* note 64.

⁹⁹ IBA I, at 12 ("[T]he preemption standard governing the NBA and HOLA is the same."); 12 U.S.C. § 1465(a).

¹⁰⁰ 15 U.S.C. § 1693 *et seq.*

¹⁰¹ 15 U.S.C. § 1693o-2.

¹⁰² See Julian Morris, *ICLE Comments to Federal Reserve Board on Regulation II NPRM*, INT'L CTR. L. & ECON. (Apr. 23, 2024), <https://laweconcenter.org/resources/icle-comments-to-federal-reserve-board-on-regulation-ii-nprm>.

restrictions that would carve out certain portions of transactions and subject them to even lower interchange-fee price controls.

One wrinkle is that Sen. Durbin and Illinois have argued that nothing in Durbin amendment explicitly preempts states from going further on interchange-fee regulation.¹⁰³ That's true; the Durbin amendment was silent on credit-card fees and did not expressly preempt state laws on debit fees (if any state had wanted to set even lower caps for smaller banks or such, arguably they could try).

The lack of express preemption in Dodd-Frank does not, however, mean that states have *carte blanche*. State laws still must not conflict with or frustrate the purposes of federal laws. The IFPA deals with both debit and credit. For debit cards, one could argue there's at least an argument that Congress, by regulating debit interchange fees, left some room for states to add protections, or conversely that Congress occupied the field of setting reasonable debit fees by delegating to the Fed. That debate aside, for credit cards (which are the majority of interchange dollars at stake in IFPA), there is no federal statute directly on point; it's purely the NBA and general banking law that govern.

The district court found that, unlike the NBA (and HOLA), the Durbin amendment is analyzed under more traditional conflict principles.¹⁰⁴ As a result, they agreed with Illinois and Durbin that the Durbin amendment only set a ceiling on interchange fees for debit cards.¹⁰⁵ Moreover, the court found that a Dodd-Frank revision¹⁰⁶ limited the preemptive effect of the NBA, finding it did "not extend to other, non-national bank or savings associations participants in credit and debit card transactions, including Card Networks like Visa or Mastercard."¹⁰⁷

B. The Dormant Commerce Clause and Discrimination Against Out-of-State Banks

State banks from outside of Illinois argued that the IFPA was unlawful as applied to them because it would set up a form of discrimination if national banks are protected from the IFPA's mandates, but they would not. They argued both on the grounds of the so-called "dormant" Commerce Clause and a provision of federal law that protects out-of-state state banks.¹⁰⁸

Here, the IFPA dictates the permissible fee structure for a contract (the card transaction) that is not confined within Illinois. The fee arrangement is part of interstate commerce: funds flow from an out-of-state issuing bank to an Illinois merchant's bank, coordinated by a network often headquartered elsewhere. By setting a fee component to \$0, Illinois is effectively controlling the price of an element of an interstate service (card-payment processing) beyond its borders. If another state were

¹⁰³ Durbin Amicus, *supra* note 94, at 11; *Illinois Brief*, *supra* note 93, at 26-29.

¹⁰⁴ IBA I, at 14.

¹⁰⁵ *Id.*

¹⁰⁶ 12 U.S.C. § 25b(h)(2).

¹⁰⁷ IBA I, at 13.

¹⁰⁸ See 12 U.S.C. § 1831a(j)(1).

to require a different fee structure (say, entirely hypothetically, if some state required a minimum interchange fee on taxes to ensure banks cover tax-handling risk), compliance would be impossible; issuers and networks cannot simultaneously obey conflicting state commands in a unified system. Arguably, this would lead to the type of impermissible extraterritorial regulation by a state that the Dormant Commerce Clause is supposed to prevent.

*Brown-Forman Distillers Corp. v. New York State Liquor Authority*¹⁰⁹ is instructive: New York’s law made distillers affirm that their New York prices were no higher than prices in other states; the Supreme Court struck it down because it effectively controlled the distiller’s out-of-state pricing (the distiller had to change out-of-state prices to avoid New York penalties).¹¹⁰ Similarly, IFPA pressures networks/issuers to adjust their conduct everywhere to avoid Illinois penalties (the simplest compliance is to program systems never to charge on any state’s taxes, but that then imposes Illinois’s rule nationally—a classic extraterritorial effect). In essence, Illinois is leveraging its market power (access to Illinois merchants/customers) to dictate fee terms nationwide for transactions involving Illinois components. Courts frown on such state overreach.

It’s notable that the 7th U.S. Circuit Court of Appeals, which includes Illinois, has itself invalidated a state law on extraterritoriality grounds. In *Legato Vapors v. Cook*,¹¹¹ Indiana imposed strict regulations on out-of-state manufacturers of vaping liquid if their products were sold in Indiana. The 7th Circuit held the law unconstitutional, describing the act as written: “so as to have extraterritorial reach that is unprecedented, imposing detailed requirements of Indiana law on out-of-state manufacturing operations.”¹¹²

The IFPA likewise could be described as imposing Illinois’ economic regulation on out-of-state banks and networks. The parallel is not perfect (*Legato* involved physical manufacturing standards), but the principle is analogous: one state dictating operational requirements to producers in other states.

Nonetheless, the district court did not see it this way. The court found that the IFPA does not explicitly discriminate against out-of-state interests. It instead applies equally to all issuers and merchants regardless of domicile.¹¹³ The out-of-state banks tried to argue the Dormant Commerce Clause would be violated because in-state banks would not be subject to the rules, due to Illinois state law. But this argument that in-state interests benefit at the expense of out-of-state interests was severely undercut by the fact that the court dismissed the challenge by the Illinois banks due to Illinois having sovereign immunity for state-law claims in federal courts.¹¹⁴ The court found that

¹⁰⁹ See *Brown-Forman v. N.Y. State Liq. Auth.*, 476 U.S. 573 (1986).

¹¹⁰ *Id.* at 582-84.

¹¹¹ See *Legato Vapors, LLC v. Cook*, 847 F.3d 825 (7th Cir. 2017).

¹¹² *Id.* at 827.

¹¹³ IBA I, at 31 (“[T]he wildcard laws apply to all entities doing business [in] Illinois.”).

¹¹⁴ *Id.* at 6 (dismissing the state banks’ claims that state law was violated on sovereign immunity grounds).

since in-state banks are subject to the mandates of the IFPA, out-of-state banks would not be treated differently.

The court did, however, allow for more briefing on the question of whether federal law protects out-of-state banks by extending the preemption of state law to the same extent as national banks.¹¹⁵ After more briefing, the court found that federal law did, in fact, demand similar treatment for out-of-state banks as national banks. And “because the Court granted the preliminary injunction with respect to nationally chartered banks, forcing out-of-state state banks to comply with the IFPA would run afoul” of the law.¹¹⁶

C. Field Preemption vs Conflict Preemption

Some commenters have suggested an alternate framing: that federal law (NBA and HOLA) so comprehensively covers bank charges that there is field preemption—*i.e.*, states have no role at all in regulating the rates/fees charged by national banks. While the Supreme Court has more often used conflict-preemption language (“significant interference”), the effect is nearly field-like in areas like interest rates and fees. The IFPA could be seen as conflicting with the full purposes of federal banking regulation by disrupting a uniform nationwide system of charges.

Additionally, one could argue the law conflicts with specific provisions of the Electronic Fund Transfer Act (for debit) or the Truth in Lending Act (for credit) if any such provisions implied no state additions. The Durbin amendment, for example, implicitly suggested that large issuers’ fees should be reasonable and proportional, but it did not set an exact amount for credit cards. It’s arguable (though not particularly strong) that Congress choosing not to regulate credit interchange might imply intent that it be left to the market (and thus, that state intervention undermines that intent). But courts typically hesitate to find “implied preemption” from congressional silence, especially given that the NBA covers the ground.

This, however, cuts the other way as well. Even after further briefing, the district court found that the Federal Credit Union Act (FCUA) is subject to more traditional conflict-preemption analysis.¹¹⁷ Instead of the *Barnett Bank* “significant interference” standard, the law was subject to whether it would be “impossible’... to comply with both state and federal law or... [when] state law... constitutes an ‘obstacle’ to satisfying the purposes and objectives of Congress.”¹¹⁸

The federal credit unions pointed to the statutory language that states FCUA gives the NCUA exclusive power to regulate them. But the court found that NCUA regulations do not preempt all state laws regulating credit cards.¹¹⁹ As a result, the FCUA’s preemption clause does not appear to

¹¹⁵ *Id.* at 30-31.

¹¹⁶ IBA II, at 7-8.

¹¹⁷ *Id.* at 4.

¹¹⁸ *Id.* at 4 (quoting *Nelson v. Great Lakes Educ. Loan Servs., Inc.*, 928 F.3d 629, 650 (7th Cir. 2019)).

¹¹⁹ *Id.* at 3-5.

implicate the substance of what the IFPA is regulating.¹²⁰ Therefore, federal credit unions continue to be subject to IFPA at this point.

In conclusion, federal preemption—especially via the NBA and HOLA—poses a formidable obstacle to the IFPA. The early court rulings vindicate that view, carving out national banks and savings associations from the law’s reach. If the trend holds, Illinois’ experiment may only fully bind those institutions least involved in card issuance, raising the question of whether the law can achieve any meaningful effect at all. When state law collides with the entrenched powers of national banks in the domain of fees and lending terms, historically, the state law has given way. The IFPA appears destined for the same fate, unless higher courts carve out a novel exception.

D. Severability and Practical Effect

If a court definitively rules that the IFPA is preempted for all federally chartered banks and savings associations (which include most major credit-card issuers—*e.g.*, Chase, Bank of America, Citi, Wells Fargo, Discover Bank, and Capital One are all national banks or federal thrifts), as well as out-of-state state banks, then the law would only effectively apply to Illinois-chartered banks and state and federal credit unions.

That outcome would be somewhat perverse: Illinois’ own community banks (if state-chartered) would be subject to the fee ban, while larger national competitors would not. The competitive imbalance and reduced scope of coverage (a large majority of card volume is from federally chartered issuers) would severely undermine the law’s intent. Indeed, merchants would still pay interchange fees on taxes for most cards (since most cards are from national banks), undercutting the law’s efficacy.

The state-chartered institutions would suffer competitive harm or feel pressure to reorganize under a federal charter to escape the rule. Moreover, it is completely unclear where this would leave the card networks, who are presumably still under the law but aren’t normally in charge of collecting the interchange fees, rather than just processing payments. Given such an outcome, Illinois might abandon the law, or a court might find that the IFPA, in its entirety, is preempted due to the dominance of federal issuers in the market.

The IFPA does have a severability clause, although the courts have not yet reached the question of how that would work. It is clear, however, that the practicality of the law only applying to a few institutions is questionable.

E. Legal Arguments Against the IFPA Conclusion

Legally, the IFPA is on shaky ground. It is likely preempted by the NBA and HOLA and impermissibly harms out-of-state banks. As such, the temporary injunction is likely to be made permanent. If state-chartered banks and credit unions, federally chartered credit unions, payment networks, and

¹²⁰ *Id.*

other non-bank payment-service providers remain bound by the act, the consequences would be so absurd as to be almost comical. One imagines the General Assembly would likely rescind the remnants of the act.

If, on the other hand, the court finds for Illinois at the merits stage, the harms would not be merely absurd, but catastrophic. Most likely, other states would follow suit, resulting in a patchwork of interchange regulations that would fracture the seamless national payments system, ultimately harming both consumers and merchants through reduced rewards, higher banking fees, and diminished innovation in payment technologies.

VI. Conclusion

Illinois' Interchange Fee Prohibition Act represents an unprecedented state-level effort to impose price controls on certain components of merchant transactions. While ostensibly aimed at protecting merchants from the burden of paying interchange fees on sales taxes and gratuities, it would create a host of economic and legal problems that far outweigh its modest purported benefits.

The law's enactment was essentially a political *quid pro quo*, whereby Gov. Pritzker sought to shift the cost burden associated with the state's previously over-generous sales-tax discount from taxpayers to issuing banks. But doing so would undermine the longstanding two-sided market equilibrium of the payments ecosystem. As this white paper has shown, the cost of electronic sales-tax collection does not scale in proportion to sales, so it would be inefficient and inappropriate to remove interchange fees from sales tax. Removing interchange fees from gratuities would add insult to injury.

Payment-card networks form a nationwide (indeed, global) ecosystem where uniform rules, scale efficiencies, and cross-side subsidies have achieved near-universal card acceptance and very wide-spread consumer adoption. The IFPA's attempt to carve out a special rule for Illinois disrupts this uniformity and would yield, at best, modest gains to big-box retailers at significant cost to banks and consumers, both locally and nationwide.

The IFPA's benefits would be concentrated and visible (Illinois merchants keep or are rebated the portion of each card sale related to tax and tips), while its costs are diffuse and largely hidden (consumers facing higher banking costs or fewer perks; banks and processors spending additional resources on compliance; and the system overall becoming marginally less efficient).

Empirical evidence from analogous regulatory interventions (the Durbin amendment, the EU's Interchange Fee Regulation, Australia's interchange-fee price controls) casts doubt on the notion that consumers will see tangible benefits through lower prices. Instead, those consumers may effectively subsidize merchants through higher bank fees or lost rewards—an outcome at odds with the populist rationale often given for such regulations.

In short, the IFPA risks distorting the balance of the two-sided card market in ways that ultimately harm one side (cardholders) more than they help the other (merchants). If laws similar to the IFPA

were replicated in other states, the result would be a patchwork of varying state interchange-fee rules that would produce chaos and more widespread harm.

Legally, the IFPA appears on a collision course with well-established principles of federal supremacy in banking regulation. The potential for conflicting state policies, should others emulate or vary the Illinois approach, underscores why the Commerce Clause entrusts Congress (not individual states) with the power to regulate national economic networks.

Moreover, the overlay of federal banking law—particularly for nationally chartered card issuers—provides robust independent grounds to nullify the IFPA with respect to most major market participants. The NBA preemption doctrine, as reinforced by *Barnett Bank* and related OCC regulations, makes clear that states cannot dictate the fees or charges earned by national banks in providing their services, if such dictates meaningfully interfere with bank operations. Interchange fees, being a core part of credit-card operations, fall within that protected sphere. The early court injunction shielding national banks from the IFPA foreshadows a likely permanent preemption ruling. In effect, even if Illinois' law were constitutionally permissible in theory, it might largely be inapplicable to the predominant actors in practice, due to federal preemption.

What remains, then, of the IFPA? If the preliminary injunction were to be overturned and the IFPA came into effect, it would impose great harm on the nation's banks and their customers. If, ultimately, only state-chartered banks and credit unions must comply, the law's impact dwindles and its distortions (penalizing local banks and their customers relative to bigger out-of-state banks and their customers) grow.