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TO: State Representative John Bradley, Chairman, House Revenue & Finance Committee
State Representative Jack Franks, Chairman, House State Government Administration Committee

FROM: Rob Karr, President
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RE: *Illinois Vendor Collection Allowance*

DATE: February 2, 2014

At the first combined hearing of your respective committees on Friday, January 17, 2014, I was asked to prepare an overview of the Illinois vendor discount also known as the vendor collection allowance. The following fulfills that request. If you or any member of your respective committees require additional information, IRMA stands ready to answer the request.

1. *What is the vendor collection allowance?*

It is the portion of the sales tax collected on each transaction that an Illinois retailer is allowed to retain as reimbursement for the retailer's costs of serving as the state's sales tax collector (see 35 ILCS 20/3). The vendor collection allowance was never designed or intended to incent job creation or economic development or a certain economic behavior.

2. *Why does it exist?*

The state recognizes that Illinois retailers bear costs for administering the state's sales tax code that would otherwise be borne fully by the state. It is also a recognition that the state could never collect sales tax as efficiently and effectively. The discount exists as reimbursement for services rendered by Illinois retailer's to the state. Those services are the retailer's costs of serving as the administrator and collector of the Illinois occupation and use tax code on behalf of the state. In short, the discount is a reimbursement for services rendered by retailers to the state. State statute makes exactly this distinction in 35 ILCS 20/3 where it states "...which is allowed to **reimburse the retailer for the expenses incurred in keeping records, preparing and filing returns, remitting the tax and supplying data to the Department on request.**"

3. *How does the vendor discount work?*

Retailers are allowed to keep 1.75% of the sales tax collected and remitted on each transaction as reimbursement for the retailers' costs of serving as the state's sales tax interpreter and collector. As an example, if a customer purchases \$100 of goods and the state tax of 6.25% is applied, the retailer is allowed to keep \$0.11 on this transaction (1.75% of the \$6.25 in tax collected on the \$100).

4. Does the vendor discount reimburse the retailer for all their costs of serving as the state's tax collector?

No. In fact, it represents approximately 50% of the retailer's costs. Therefore, at the current 1.75% Illinois' vendor discount is a partial reimbursement. Please find attached a PriceWaterhouseCooper study highlighting this fact. They peg the true cost, at a national level, of between 3% and 4%. Given the fact that Illinois is universally recognized as having the most complicated sales tax code in the nation, the true cost facing Illinois retailers exceeds 4%.

5. Why doesn't the vendor discount cover all the retailer's costs of the services they provide the state?

First, Illinois has the most complicated sales tax code in the nation. Illinois is complicated because of the various rates and different and often overlapping jurisdictions. For example, the state has two rates – 0% and 6.25%. There are local rates which push the overall rate as high as 12%. Jurisdictional issues include special business development zones, enterprise zones, tax increment financing districts, local education taxes, public safety taxes, etc. All of these factors retailers must navigate and account for on a location-by-location basis.

Second, Illinois requires quarter-monthly reporting (four times per month) for sellers with an average monthly liability of \$20,000 (\$320,000 in sales per month at the state rate of 6.25% and \$205,128 at the Cook County rate of 9.75%). These quarter-monthly filers must file on the 7th, 15th, 22nd, and last day of every month. This is the fastest remittance in the nation and requires reconciliation in the next month for the previous month.

Third, retailers are significantly subsidizing sales tax collection for the state. Retailers are charged a swipe fee for accepting credit cards (e.g. VISA, MasterCard, Amex, etc.). VISA and MasterCard, the least expensive of the cards, charge the retailer between 1.5% plus \$0.10 and 3% plus \$0.10 per transaction. These fees are applied to the cost of goods and the sales tax. Using my example from above, someone purchases \$100 of goods and pays 6.25% sales tax, the average discount fee on this purchase with a VISA or MasterCard would be \$2.49 (2.25% + \$0.10). The sales tax portion, \$6.25, accounts for \$0.14 of the swipe fee. The vendor collection allowance on this transaction is \$0.11 meaning the credit card swipe fees consumed the entire vendor allowance plus cost the retailer an additional \$0.03. Therefore, an Illinois retailer is subsidizing the collection of the sales tax for the state each time a consumer uses credit or debit. As an aside, credit and debit transactions now account, on average, for over 66% of all transactions. Some retailers average over 80%. These numbers grow annually. This represents a significant subsidization of the state's sales tax collection by the retail community. Increasing the vendor collection allowance would eliminate this discrepancy but still not fully reimburse Illinois retailers for their additional costs detailed in the first and second points. While IRMA is not calling for an increase in the discount, these facts clearly demonstrate that the partial reimbursement is, indeed, a reimbursement for the costs of serving as the state's sales tax collector and remitter.

Fourth, while the Illinois Department of Revenue (IDOR) provides guidance, when it comes to actual interpretation and application of the Illinois sales tax code, the responsibility and liability is borne by the retailer.

6. *Don't large retailers benefit unfairly?*

Not at all. Given the fact they operate in many more jurisdictions, their tax process is more complicated. The same PriceWaterhouseCoopers study (attached) demonstrates that, on average, the cost of collection for larger retailers is 2.17%, for medium retailers 5.20%, and for small retailers 13.47%. The overall average is 3.09%. It must be noted that this study assumed that large retailers get the 'float' (i.e. interest they can earn on the money they collect before it is remitted to the state) on the tax monies. Since Illinois is a quarter-monthly state, there is no 'float' for the large retailers. Therefore, the true reimbursement for a larger retailer is higher than 2.17% in Illinois and the average for all Illinois retailers is higher than 3.09%. This study demonstrates that no matter how one looks at the vendor discount, Illinois' reimbursement is a partial reimbursement no matter the size of the retailer.

7. *Don't computers address these issues?*

No. Interestingly, computers were the reason used to claim that Illinois retailers could handle faster remittance, multiple rates, overlapping jurisdictions, etc. In other words, computers were used as the reason Illinois retailers could handle a more complicated tax code. Therefore, computers have made the allowance even more necessary, not less so.

8. *Why is the Illinois vendor discount set at 1.75%?*

Prior to January 1, 1990, the Illinois vendor discount was 2.1%. As a result of sales tax reform, when the sales tax rate was increased from 5% to 6.25%, the discount was reduced to 1.75% in order to keep retailers from 'profiting'. Since that time, the sales tax in Illinois has become far more complicated, as noted in the answer to Question #5, thereby significantly increasing the cost of collection.

9. *What is the vendor discount in other states?*

Please find attached a chart detailing the vendor discount in every state in the nation as of January 1, 2014. Briefly, 26 states allow a discount. Of those, 13 states cap the discount at some arbitrary figure (e.g. no more than \$400 per month) and 13 states, including Illinois, do not cap. Of Illinois' border states, Indiana, Missouri, and Wisconsin have no cap. Missouri's vendor collection allowance is higher than Illinois' at 2%. Nationally, Illinois ranks third. Colorado is at 3.3%, Missouri at 2%, and Illinois at 1.75% - and their sales tax codes are not as complicated as Illinois'. No discount and capping the discount are affronts to retailers for the reasons noted above. Furthermore, just because other states have done it doesn't mean Illinois should do it. Despite the fact that Illinois' allowance is half or less of the true costs imposed on retailers, it is one economic area where Illinois compares favorably to most other states.

10. *Who else is allowed a vendor discount?*

The State of Illinois. The Illinois Department of Revenue retains collection allowances for their role in remitting various taxes back to local governments. IDOR has repeatedly testified in committee that these discounts reflect their cost of doing business. That same reasoning holds true for Illinois retailers. IRMA does not begrudge IDOR their discounts and agrees with their 'cost of business' argument. It must be noted that IDOR is receiving monies generated and collected by retailers and is apportioning the money to local governments based on formulas. Private sector retailers, on the other hand, are doing far more as noted previously but particularly in Question #5. The following chart shows, by fund, what percentage of receipts

for that fund IDOR is allowed to retain and, based on FY 2013 numbers, the amount of money IDOR retained. Again, this in no way should be interpreted to cast aspersion on the legitimacy of IDOR collecting such a fee. They do have costs for their processes as do Illinois retailers.

Tax Type	Total Collections	Admin. Fee (%)	Admin. Fee (\$)
Soft Drink Tax	\$9,795,485.69	2.00%	\$199,907.87
E911 Surcharge - Chicago	\$7,828,216.59	3.00%	\$223,436.22
Home Rule Use Tax	\$27,756,578.33	2.00%	\$555,131.57
Business District Tax	\$12,150,840.59	2.00%	\$247,976.44
County Option Motor Fuel Tax	\$31,829,830.26	2.00%	\$636,596.61
Illinois Sports Facility Tax	\$39,420,150.16	4.00%	\$1,576,806.00
Metropolitan Pier and Exposition (Food and Beverage)	\$41,920,338.86	2.00%	\$806,046.89
Illinois Tourism Fund (Hotel Tax)	\$19,911,207.80	4.00%	\$796,448.30
County School Facility Tax	\$47,546,799.16	2.00%	\$970,370.56
County Flood Protection District Tax	\$11,198,121.70	2.00%	\$228,527.95
E911 Surcharge - non-Chicago	\$4,470,022.67	3.00%	\$134,100.68
Municipal Simplified Telecommunications Tax	\$271,266,713.64	0.50%	\$1,329,008.49
Metro East Transit District Fee (MEDFEE)	\$452,580.46	2.00%	\$9,236.34
Municipal Automobile Renting Tax	\$6,055,611.19	1.60%	\$98,384.18
County Automobile Renting Tax	\$247,780.31	2.00%	\$5,054.95
TOTAL	\$531,850,277.41		\$7,817,033.05

11. What is the fiscal impact of the vendor discount?

According to the Fiscal Year 2012 Tax Expenditure Report published annually by the Office of the Illinois Comptroller, the vendor discount amounts to \$121 million. For the edification of the members of your respective committees, using the same reports for the last decade, IRMA prepared the following chart:

FISCAL YEAR	Vendor Collection Allowance	VCA % of ALL EXPENDITURES
2012	\$121	1.40%
2011	\$116	1.70%
2010	\$109	1.60%
2009	\$112	1.70%
2008	\$127	1.90%
2007	\$126	1.70%
2006	\$126	1.90%
2005	\$119	1.80%
2004	\$113	1.80%
2003	\$107	1.80%
2003-2012	\$1,176	1.73%
2008-2012	\$585	1.66%
2003-2007	\$591	1.80%

As you can see, over the last decade, the vendor discount accounts for 1.73% of all tax expenditures. Considering the administrative and financial benefits the state receives, the fact that the current reimbursement level is not representative of the true cost of collection, and the fact that retail is underwriting costs that should be borne by the state, the state is receiving an extraordinary benefit from the vendor collection allowance.

Clearly, from a factual, data-driven standpoint Illinois' current vendor collection allowance is: (1) a reimbursement for services rendered to the state and not an incentive; (2) a partial reimbursement that is not even close to covering the actual cost of collection borne by Illinois retailers; (3) one of the few areas from a retail standpoint where the State of Illinois compares favorably to other states.