TACIR INSIGHT
TENNESSEE ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS
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EQUITABLE VENDOR COMPENSATION SHOULD CONSIDER THE RELATIVE COSTS OF SALES TAX COLLECTION

Background

The sales tax is a mainstay of Tennessee's state revenue, and businesses play a key role in collecting and remitting it. In the past, Tennessee, like some other states, allowed its businesses to retain a percentage of the sales tax they collected as compensation, but eliminated such compensation in 2000, restoring it only temporarily in fiscal year 2022-23. Public Chapter 1013, Acts of 2024, required the commission to study vendor compensation and the costs to businesses of paying card transaction fees on the sales tax portion of transactions.

There are differing views as to whether businesses should be understood as tax collectors or taxpayers of the sales tax, and available evidence and legal precedent do not decisively recommend one view over the other. Past research does suggest, though, that the costs of collection are proportionally greater for small businesses than large ones, which has led most states that offer vendor compensation to use tiered rates and caps to ensure compensation does not exceed actual costs for large businesses. Many businesses have also called attention to credit and debit card transaction fees that they pay, pointing out that these fees are inclusive of sales tax. While there have been proposals in multiple states to exclude sales tax from these fees in the past, none had passed until this year in Illinois. That legislation, however, has been challenged in court by financial institutions, who say it is preempted by federal law.

Findings and Recommendations

The commission recommends that

- if the state were to reinstitute vendor compensation for sales tax collection, that it continue to use a tiered set of rates and a cap structured to ensure compensation for smaller businesses for whom the relative costs of collection are greatest without creating either a windfall for larger businesses or a revenue shortfall for the state, and
- that Tennessee refrain from taking any action on card transaction fees until more information is available from the test case in Illinois.

See TACIR's full report at the following link for additional information: https://www.tn.gov/tacir/tacir-publications.html.