

Date of Hearing: April 21, 2025

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Avelino Valencia, Chair

AB 1065 (Ortega) – As Amended April 21, 2025

SUBJECT: Credit card transaction fees: tax payments: Consumer Inflation Reduction and Tax Fairness Act

SUMMARY: Establishes the Consumer Inflation Reduction and Tax Fairness Act, which prohibits the charging or receiving of interchange fees on the tax portion of an electronic payment transaction. Specifically, **this bill:**

- 1) Prohibits an issuer, a payment card network, an acquirer bank, or a processor from receiving or charging a merchant any interchange fee on the tax amount of an electronic payment transaction if the merchant informs the acquirer bank or its designee of the tax amount as part of the authorization or settlement process for the electronic payment transaction.
- 2) Requires the merchant to transmit the tax amount data as part of the authorization or settlement process to avoid being charged interchange fees on the tax amount of an electronic payment transaction.
- 3) Provides that a merchant that does not transmit the tax amount data, as required in 2), may submit tax documentation for the electronic payment transaction to the acquirer bank or its designee within 180 days after the date of the electronic payment transaction.
- 4) Establishes that if the merchant submits documentation within 180 days, as provided in 3), the issuer must credit the merchant the amount of interchange fees charged on the tax amount of the electronic payment transaction within 30 days after the merchant submits the necessary tax documentation.
- 5) Establishes that the requirements in 1-4) do not create liability for a payment card network regarding the accuracy of the tax data reported by the merchant.
- 6) Prohibits a payment card network, acquirer bank, or processor from altering or manipulating the computation and imposition of interchange fees by increasing the rate or amount of the fees imposed on other parts of the transaction (i.e., other than the interchange on tax) in order to circumvent the effects of this measure.
- 7) Provides that a person or entity that knowingly engages in a pattern or practice of assessing interchange fees on the tax portion of an electronic payment transaction in violation of this measure, may be subject to enforcement under the Unfair Competition Law.
- 8) In determining liability under this section, the court is required to consider all of the following:
 - a) Whether the person or entity had control over or access to the tax amount data.
 - b) Whether the person or entity took reasonable steps to implement and enforce compliant processes for authorization, settlement, and fee computation.

- c) Whether any violation was the result of merchant or point-of-sale vendor error, or a failure to transmit sufficient or accurate tax data.
- 9) Provides that there is no liability on a payment card network, acquirer bank, issuer, or processor for any errors, omissions, or misstatements in tax data provided by a merchant or its point-of-sale vendor, provided the entity did not knowingly disregard reliable information regarding such errors.
- 10) Defines key terms, including:
- a) “Electronic payment transaction” means a transaction in which a person uses a debit card, credit card, or other payment code or device, issued or approved through a payment card network to debit a deposit account or use a line of credit, whether authorization is based on a signature, personal identification number, or other means.
 - b) “Interchange fee” means a fee established, charged, or received by a payment card network for the purpose of compensating the issuer for its involvement in an electronic payment transaction.
 - c) “Tax” means the following:
 - i. Sales and Use Tax Law.
 - ii. Bradley-Burns Uniform Local Sales and Use Tax Law.
 - iii. Transactions and Use Tax Law.
 - iv. Cigarette and Tobacco Products Tax Law.
 - v. Alcoholic Beverage Tax Law.
 - vi. Cannabis Tax Law.
- 1) **EXISTING LAW:**
Caps consumer liability for unauthorized credit card charges and obligates issuers to absorb fraud-related losses. (15 United States Code Section 1643(a); 12 Code of Federal Regulations Section 1026.12(b).)
- 2) Implements consumer protections under the Truth in Lending Act; governs issuer obligations in the event of credit card fraud or dispute. (Title 12 Code of Federal Regulations Section 1026.12(b).)
- 3) Governs electronic debit card transactions and limits consumer liability for unauthorized use. (Title 15 United States Code Section 1693 *et seq.*)
- 4) Requires the Federal Reserve to set standards for debit card interchange fees and mandates network routing options for merchants. (Title 15 United States Code Section 1693o–2.)
- 5) Implements the Durbin Amendment and sets the interchange fee cap and fraud adjustment for debit card issuers. (Title 12 Code of Federal Regulations part 235.)

- 6) Requires merchants to collect and remit sales tax. (Revenue and Taxation Code Section 6203.)
- 7) Exempts sale of most food products for human consumption from sales tax. (Revenue and Taxation Code Section 6359.)
- 8) Prohibits unlawful, unfair, or fraudulent business acts or practices. (Business and Professions Code section 17200 *et seq.*)
- 9) Defines “credit card” for purposes of consumer credit laws in California. (Civil Code Section 1747.02.)
- 10) Defines “debit card” and includes general-use prepaid cards. (Civil Code Section 1748.30.)
- 11) Governs the imposition, collection, and administration of sales and use taxes in California. (Revenue and Taxation Code Section 6001 *et seq.*)
- 12) Establishes the excise tax on cannabis and cannabis products. (Revenue and Taxation Code Section 34010 *et seq.*)
- 13) Governs excise taxes on tobacco products. (Revenue and Taxation Code Section 30001 *et seq.*)
- 14) Authorizes cities and counties to impose local sales and use taxes. (Revenue and Taxation Code Section 7200 *et seq.*)

FISCAL EFFECT: This bill is keyed non-fiscal.

COMMENTS:

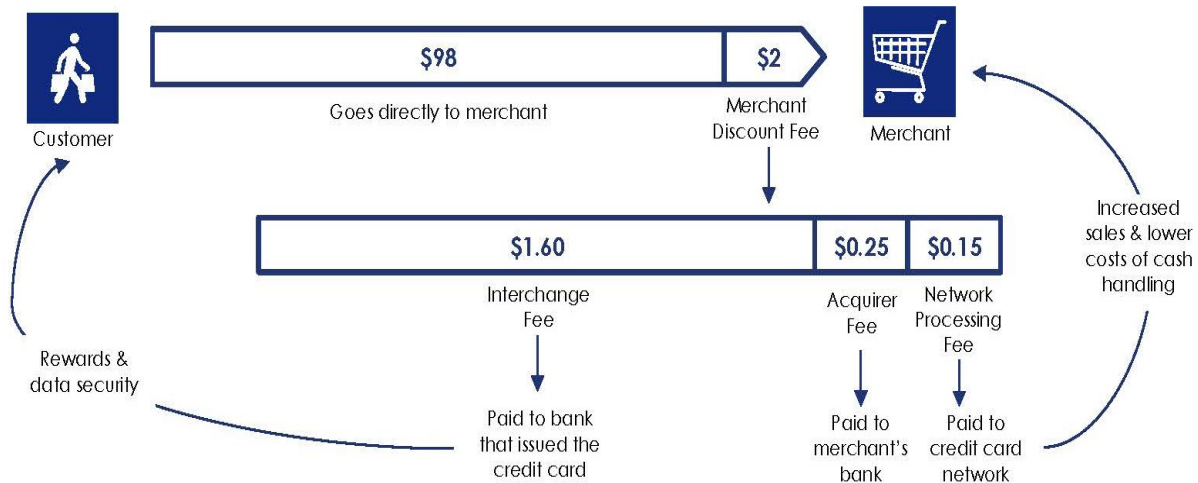
- 1) Purpose. According to the author:

It is absurd to require businesses to collect and track taxes at their own expense while allowing credit card companies to mark up those same taxes for a profit. It is also absurd for credit card companies to charge a fee on the tips left by generous customers that businesses collect for their employees.

To address these obvious inequities, AB 1065 would prohibit a card network, bank, or card processor from charging a business a swipe fee on the tax or tip portion of a debit or credit card transaction. The bill establishes a civil penalty for those entities that choose to violate this prohibition.

- 2) Interchange Fees. Card networks like Visa and Mastercard set interchange fees. They are paid from a merchant bank to a consumer bank to cover the consumer bank's costs, including transaction processing and the risk of bad debt for credit cards.

Interchange fees are typically billed to merchant banks as a one-time fee but represent several smaller fees rolled into one. Interchange fees vary based on the type of card used and whether the card is swiped, keyed in, or processed remotely. Fees are typically a percentage of the transaction plus a fixed amount.



Source: Electronic Payments Coalition¹

In 2011, the Federal Reserve issued Regulation II, implementing what is known as the Durbin Amendment, which required the Federal Reserve to set debit interchange fees for large banks based on the cost of providing the services, capping debit card interchange fees at 0.05% plus \$0.21 per transaction for large issuers. This was the first time transaction fees were required to be regulated. Regulation II does not cover credit card interchange.² By contrast, in Europe, the European Commission capped interchange fees for debit and credit cards.

Card Type	United States ³	Europe ⁴
Debit Card	Capped at ~\$0.21 + 0.05% (regulated banks)	Capped at 0.2% of transaction value
Credit Card	Range: ~1.3% to 3.5%, depending on card and method	Capped at 0.3% of transaction value

- 3) State Legislation and Federal Preemption. This year, interchange fee bills are pending in Colorado, the District of Columbia, Massachusetts, Nevada, New York, Pennsylvania, Rhode Island, Tennessee, Texas and Vermont.

In 2024, Illinois became the first state to enact a law addressing interchange fees associated with revenues not retained by a business. (205 ILCS 730.). Similar to the introduced version

¹ <https://www.electronicpaymentscoalition.org/wp-content/uploads/2020/07/July-2020-Overview-of-Interchange.pdf>

² <https://www.congress.gov/crs-product/IF11893>

³ <https://www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm>

⁴ <https://www.clearlypayments.com/blog/an-overview-of-interchange-rates-and-payment-processing-in-the-eu/>

of AB 1065,* the Illinois Interchange Fee Prohibition Act (IFPA) prohibits financial institutions from charging interchange fees on portions of transactions attributable to state and local taxes and gratuities. (*Recent amendments to AB 1065 remove gratuities and narrow the tax definition.)

In Illinois, the American Bankers Association, the Illinois Bankers Association, America's Credit Unions, and the Illinois Credit Union League filed a lawsuit challenging the law, arguing it is federally preempted, and requested a preliminary injunction. In December 2024, U.S. District Court Judge Virginia Kendall issued a partial preliminary injunction, preventing enforcement of the IFPA against national banks and federal savings associations, citing likely preemption by the National Bank Act (NBA) and the Home Owners' Loan Act (HOLA). The Court later expanded the preliminary injunction to include out-of-state banks. However, IFPA still applies to Illinois-chartered banks, credit unions, and payment card networks remains in effect.⁵

From the Assembly Judiciary Analysis of AB 1065 on April 8, 2025. (*Please refer to the Assembly Judiciary analysis for the complete overview of federal preemption and liability issues.*):

Opposition's concerns - Preemption. Opponents of AB 1065 have also raised the prospect that the bill may be preempted by federal law, particularly as applied to national banks and federally chartered financial institutions. Under the National Bank Act (12 United States Code Section 24) and case law interpreting it—including *Watters v. Wachovia Bank, N.A.* (2007) 550 U.S. 1 and *Barnett Bank of Marion County, N.A. v. Nelson* (1996) 517 U.S. 25—the Office of the Comptroller of the Currency has broad authority to regulate the powers and operations of national banks. State laws that “significantly interfere” with a national bank’s exercise of its federally granted powers—such as the ability to offer and price credit products or to charge fees associated with payment processing—are likely preempted.

Because AB 1065 seeks to regulate interchange fees, which are set by private payment networks and flow from acquirers to issuers, opponents argue that the bill could intrude upon the federally-protected authority of national banks to participate in and structure card-based payment systems, including setting terms and fees. As discussed above, similar arguments are being debated as a core aspect of the litigation surrounding the Illinois Interchange Fee Prohibition Act.

To the extent AB 1065 applies to national banks or their agents and banks chartered out-of-state, it may face similar preemption challenges. . . .

- 4) Business and Consumer Impact. In 2023, California merchants paid an estimated \$1.7 billion in swipe fees on sales tax, representing a significant and recurring cost of compliance.⁶ Supporters state interchange fees cost American families over \$1,000 annually. According to the National Federation of Independent Business, swipe fees are now the third-highest

⁵ <https://bankingjournal.aba.com/2025/03/court-extends-preliminary-injunction-to-out-of-state-banks-in-illinois-interchange-litigation/>

⁶ <https://cmspi.com/how-much-interchange-was-paid-on-sales-tax-in-the-us/>

operating expense for many small businesses, after labor and rent, and accounted for over \$130 billion in nationwide costs to merchants in 2022.

It is unclear how much revenue banks in California earn on interchange fees. Anecdotally, banks state that the revenue funds transaction processing, fraud prevention and security services, offset bad debt from consumers, account servicing, and credit card rewards programs.

While merchants will benefit from reduced interchange fees, it is unclear if AB 1065 will reduce consumer costs. Many studies show that the Durbin amendment, which capped debit card interchange fees, benefited merchants who did not pass savings on to consumers.

5) Workability.

- a) Payment Systems. Pending the resolution of the preemption issue, if the bill were narrowed to apply to state-chartered institutions, it would also present challenges. Per the Assembly Judiciary analysis of AB 1065 dated April 8, 2025:

In an amicus brief, the Office of the Comptroller of the Currency, a bureau of the United States Department of the Treasury, and the primary federal regulator of national banks, raised implementation questions regarding the law and posited that the law might create a fragmented and inefficient payment system with adverse consequences for fraud risk, consumer access, and interstate commerce. (Office of the Comptroller of the Currency, Amicus Brief in Illinois Bankers Ass’n v. Raoul, (filed Jan. 2025) <https://www.occ.treas.gov/topics/laws-and-regulations/litigation/occ-briefs.html> (as of Mar. 31, 2025).)

- b) Financial Burden. Opponents note that federal preemption “leaves credit unions and community banks to bear the financial burden, an unfair outcome that could be replicated in California.” They cite information from the Electronic Transactions Association, which estimates that 90% of payment volume comes from credit cards overwhelmingly issued by nationally chartered banks. If pre-empted, 90% of transactions would be exempted.

Supporters note that if Visa and Mastercard are prohibited from receiving interchange fees on the tax, all parts of the payment system must comply. If correct, California merchants will receive relief, and the impacts on state-chartered banks and credit unions will be minor.

- c) Technological Feasibility. Supporters and opponents disagree on whether the bill is technologically feasible. Most point-of-sales systems already itemize taxes separately and could be programmed to flag or exclude tax amounts from the total used to calculate interchange fees. Opponents note the change requires “expensive system overhauls and increased data collection, resulting in prolonged delays and operational confusion.” The California Association of County Treasurers and Tax Collectors expressed concern that businesses could require a second form of payment to pay for taxes. This could lead to non-payment.

REGISTERED SUPPORT / OPPOSITION:

Support

American Petroleum and Convenience Store Association

California Fuels and Convenience Alliance

California Grocers Association

California Restaurant Association

Opposition

California Credit Union League

Oppose Unless Amended

California Association of County Treasurers & Tax Collectors

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