SENATE BILL REPORT
SB 5494

As of January 16, 2024

Title: An act relating to government incentives for improving freight railroad infrastructure.

Brief Description: Providing incentives to improve freight railroad infrastructure.

Sponsors: Senators Wilson, J., Kuderer, King, Lovick, Dozier, Wilson, L., Liias, Schoesler, Warnick and Holy.

Brief History:
Committee Activity: Business, Financial Services, Gaming & Trade: 2/02/23; 1/18/24.

Brief Summary of Bill

- Creates business and occupation, retail sales and use, and public utility tax exemptions and credits for railroads and other eligible taxpayers for donated materials, maintenance, modernization, and new construction on short line railroad tracks.

SENATE COMMITTEE ON BUSINESS, FINANCIAL SERVICES, GAMING & TRADE

Staff: Alia Kennedy (786-7405)

Background: Railroad Classifications. There are more than 560 freight railroads in three classification levels that operate nationwide. The United States Department of Transportation's Surface Transportation Board classifies types of railroads by carrier operating revenue, annually adjusted for inflation. Most railroad lines are owned and managed by holding companies, however, some are stand-alone railroads, leased lines, or publicly owned by a state, public port, or local jurisdiction.

Class I:
- annual operating revenue is more than $943.9 million;
- large operators that cover significant portions of the country; and

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- railroads of this class operating in Washington:
  1. BNSF—1400 miles, 44 percent of the rail system; and
  2. Union Pacific—500 miles, 16 percent.

Class II:
- between $42.4 million and $943.9 million in annual operating revenue;
- midsize carriers, typically regional; and
- there is one Class II railroad operating in Washington at the Spokane interchange.

Class III—short line:
- annual operating revenue is less than $42.4 million;
- small and regional, and typically move agricultural products;
- there are 27 short line railroads operating in Washington with over 1400 miles of track—nearly 40 percent of the rail system;
- short lines average from 1 to 150 miles in length; and
- some railroads of this class operating in Washington are:
  1. Port of Chehalis Rail—1 mile;
  2. Kettle Falls International Railway—36 miles; and
  3. Palouse River and Coulee City Rail System—300 miles.

Washington State Short Line Rail Inventory and Needs Assessment. In 2015, the Legislature directed the Washington Department of Transportation to create an inventory and needs assessment on short line rail in the state. The report found that much of the existing short line rail system did not meet the state's current or future capacity and velocity needs for efficient operation. It was updated in 2021, with similar findings.

Federal and State Funding for Short Lines. The United States Department of Transportation offers several grant programs and one business tax credit worth over $176 billion, available to railroads, including short lines. The Legislature appropriated $19.54 million in the 2021-23 biennium for four freight rail improvement preservation projects that benefit short lines. The Washington State Department of Transportation provides two programs to improve rail systems in the state. The Freight Rail Investment Bank provides loans for building new or improving existing rail infrastructure for the public sector only. A total of $5.08 million is available for loans in the 2021-23 biennium. The Freight Rail Assistance Program provides grants to private and public sector railroads, rail shippers or receivers, and port districts for rehabilitation, infrastructure preservation, and economic development. For the 2021-23 biennium, a total of $7.04 million is available for grants. Requests for grants and loans for both programs in the 2021-23 biennium have exceeded available moneys.

Business and Occupation Tax. Washington's major business tax is the business and occupation (B&O) tax. The B&O tax is imposed on the gross receipts of business activities conducted within the state, without any deduction for the costs of doing business. The tax is imposed on the gross receipts from all business activities conducted within the state. Revenues are deposited in the State General Fund. There are several rate categories, and a business may be subject to more than one B&O tax rate, depending on the types of activities conducted. Current law authorizes multiple exemptions, deductions, and credits to reduce the B&O tax liability for specific taxpayers and business industries.

Retail Sales and Use Tax. Retail sales taxes are imposed on retail sales of most articles of tangible personal property, digital products, and some services. A retail sale is a sale to the final consumer or end user of the property, digital product, or service. If retail sales taxes were not collected when the user acquired the property, digital products, or services, then use tax applies to the value of property, digital product, or service when used in this state. The state, all counties, and all cities levy retail sales and use taxes. Some other local government entities and special purpose districts also impose sales and use taxes for specific purposes. The state sales and use tax rate is 6.5 percent; local sales and use tax rates vary from 0.5 percent to 3.9 percent, depending on the location.

Public Utility Tax. The public utilities tax (PUT) is a tax on public service businesses, including businesses that engage in transportation, communications, and the supply of energy, natural gas, and water. The tax is in lieu of the B&O tax. There are different rates, depending on the specific utility activity. Railroads, railroad car companies, motor transportation and all other public service businesses are taxed at 0.01926 percent. Most of the funds are distributed into the State General Fund. A portion provides financial assistance to local governments for maintenance of public works facilities.

Tax Preferences. All new tax preference legislation is required to include a tax preference performance statement. The performance statement must clearly specify the public policy objectives of the tax preference, and the specific metrics and data that will be used by the Joint Legislative Audit and Review Committee (JLARC) to evaluate the efficacy of the tax preference. In addition, an automatic ten-year expiration date is applied to new tax preferences if an alternate expiration date is not provided in the new tax preference legislation.

Summary of Bill: The bill as referred to committee not considered.

Summary of Bill (Proposed Substitute): Tax Credits. Credits against the B&O tax or PUT are allowed for certain costs related to railroad maintenance and modernization.

Class II and Class III Railroads. Class II and class III railroads, and other eligible taxpayers, are allowed a credit for expenses incurred on railroad construction, enhancements, or maintenance. The credit is equal to:

- 50 percent of the costs for short line railroad maintenance, not to exceed an amount equal to $3,500 multiplied by the number of miles of railroad track owned or leased in the state by the eligible taxpayer as of the close of the calendar year;
- 50 percent of the cost for new rail development; and
- 50 percent of the cost for railroad modernization and rehabilitation.

The credit for costs related to new rail development and railroad modernization and rehabilitation may not exceed $1 million per taxpayer each calendar year, and is limited to an annual total credit amount of $15 million each calendar year.

Credits may not be earned on expenditures used to generate a federal tax credit or expenditures funded by a state or federal grant.

Eligible taxpayers include:
- railroads owned by a port, city, or county in the state of Washington; or
- an owner or lessee of rail siding, industrial spur, or industry track located on or adjacent to a class II or class III railroad in the state of Washington.

No credit may be earned on or after January 1, 2036, and all credits must be claimed no later than January 1, 2042.

Donated Materials. A company that recycles railroad material is allowed a credit equal to the fair market value of certain railroad materials donated to and used by a class II or class III railroad.

Eligible donated materials include rail, ties, tie plates, joint bars, fasteners, switches, ballast, or other equipment that are part of the rail infrastructure it has removed from use on the main railroad line to be installed on tracks used by class II and class III railroads.

Department of Revenue must provide in rule a standard for determining the fair market value of donated materials.

Credits for donated materials may not be earned for donations to short line railroads owned by a class I railroad or any of its subsidiaries.

No credit may be earned on or after January 1, 2037, and all credits must be claimed no later than January 1, 2042.

Other Provisions. Unused credits may be carried forward and claimed in against subsequent tax liability for a period of five years, starting the year immediately following the year in which the credit was initially earned. Taxpayers may transfer all or a portion of the unused credits to any taxpayer at any time for which the credit is eligible to be claimed. No credits may be transferred more than one time.

<u>Retail Sales and Use Tax Exemption.</u> The retail sales and use tax does not apply to sales of materials required for track maintenance when purchased by:
- owners and operators of class II or class III railroads;
- any railroad or freight rail facility owned by a port, city, or county in Washington; or
- any owner or lessee of a rail siding, industrial spur, or industry track located on or adjacent to a class II or class III railroad in Washington.

The exemption may not be used by class I railroads or short line railroads owned by a class I railroad or any of its subsidiaries.

The tax exemption expires January 1, 2036.

Tax Preference Performance Statement. The bill includes a tax preference performance statement that states it is the Legislature's specific public policy to promote economic development and reduce impacts of freight transportation on roads and the environment.

Appropriation: None.

Fiscal Note: Requested on January 15, 2024.

Creates Committee/Commission/Task Force that includes Legislative members: No.

Effective Date: The bill takes effect on July 1, 2024.

Staff Summary of Public Testimony (Regular Session 2023): PRO: Railroads are vital to providing service to ports. Railroads collectively transport 250,000 carloads of different commodities each year, the equivalent of a million trucks on the highway and saving the state over 43 million dollars a year in pavement damage costs. Rail connects eastern and western Washington and transports goods to markets both domestically and internationally. Short lines are vital to rural areas and ports, as they transport millions of dollars' worth of product. The economic development component of this bill allows for much needed expansion of this infrastructure. Replacing the less-than 90-pound steel rail would serve existing and future customers for the next 100 years. The tax credit for modernization improvements for track less than 90 pounds will give the necessary support to maximize additional private investment and help the state meet its carbon reduction goals by keeping more trucks off the road. The key takeaway from a research study at Carnegie Mellon University was that policymakers should support the infrastructure improvements that allow shipments to be kept on rail as long as possible. Since COVID occurred, there has been an influx of companies looking to site in Washington. Being in the corner of the country, a lot of these companies need to have rail. This bill helps incentivizes rail companies to upgrade rail and attract some of the companies that are looking to expand into Washington. It provides maintenance improvements, helps with overall climate changes, and creates a reliable railroad system. This legislation is a proven model of accelerating infrastructure investment. It has passed in 9 other states and data has shown a 38% increase in investments back into the railroad tracks. Much of the track in Washington is at the lowest accepted status of railroad infrastructure classified by the Federal Railroad Administration. The Washington Eastern Railroad reported that most of their line needs ties replaced, and that a majority of rail for three-foot sections is 90 pounds or less which is 25 to 33% lighter than most rail operated on across the country today. Under serviced tracks require rail companies to lighten loads and operate no faster than 10 miles an hour, which slows down the process of transportation, impacting rail efficiency. Supply chain issues were only exacerbated by rail not running as efficiently as it can. Forty percent of annual railroad maintenance is unplanned, so it is important to have mechanisms in place to help improve and finance track work.

OTHER: The Port of Everett's on dock rail is the equivalent of a short-line railroad, but due to its proximity to a class one main line, the port would not qualify for investment incentives. The investments promoted in this bill would be significant in the port maintaining and growing access to their rail corridors. The definition of eligible taxpayer should change from any railroad owned by port, city, or county in the state of Washington to any railroad or rail facility owned by a port, city, or county in the state of Washington.

Persons Testifying: PRO: Senator Jeff Wilson, Prime Sponsor; Eric Temple, Portland Vancouver Junction Railroad; Patrick Boss, Columbia Basin Railroad / Central Washington Railroad; Jeff Van Schaick; Ryan Pidde, Mickleson and Co; Lori Stevens, Port of Benton; Chris Herman.

OTHER: Adam LeMieux, Port of Everett.

Persons Signed In To Testify But Not Testifying: No one.