HOUSE BILL REPORT
HB 1371

As Reported by House Committee On:
Finance

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

Brief Description: Providing incentives to improve freight railroad infrastructure.

Sponsors: Representatives Barkis, Leavitt, Orcutt, Fey, Barnard, Chapman, Low, Connors, Goehner, Chambers, Chandler, Couture, Griffey, Hutchins, Robertson, Volz, Walsh, Christian, Doglio, Schmick and Gregerson.

Brief History:

Committee Activity:

Finance: 1/31/23, 2/22/23 [DPS].

Brief Summary of Substitute Bill

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

HOUSE COMMITTEE ON FINANCE

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 12 members: Representatives Berg, Chair; Street, Vice Chair; Orcutt, Ranking Minority Member; Jacobsen, Assistant Ranking Minority Member; Barnard, Ramel, Santos, Springer, Stokesbary, Thai, Walen and Wylie.

Minority Report: Without recommendation. Signed by 1 member: Representative Chopp.

Staff: Kristina King (786-7190).

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not part of the legislation nor does it constitute a statement of legislative intent.

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 railroads:
- have an annual operating revenue of more than $943.9 million; and
- are large operators that cover significant portions of the country.

Class I railroads operating in Washington include Burlington Northern and Santa Fe (1,400 miles, 44 percent of the rail system) and Union Pacific (500 miles, 16 percent).

Class II railroads:
- have an annual operating revenue between $42.4 and $943.9 million; and
- are typically regional midsize carriers.

There is one Class II railroad operating in Washington which is located at the Spokane interchange.

Class III railroads, also known as short lines:
- have an annual operating revenue less than $42.4 million;
- are small and regional, typically move agricultural products; and
- are an average of 1-150 miles in length.

There are 27 short line railroads operating in Washington with over 1,400 miles of track, which constitute approximately 40 percent of the rail system. Some railroads of this class operating in Washington are: Port of Chehalis Rail (1 mile), Kettle Falls International Railway (36 miles), and 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 operations. 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. Additionally, the Legislature appropriated $19.54 million in the 2021-23 biennium for four freight rail improvement preservation projects that benefit short lines.

The 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 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.

However, for the 2021-23 biennium, requests for grants and loans in both programs have exceeded available monies.

<u>Business and Occupation Tax</u>.
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. 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.

<u>Retail Sales and Use Tax</u>.
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.

<u>Public Utility Tax</u>.
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 1.926 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.

<u>Tax Preferences</u>.
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 to evaluate the efficacy of the tax preference. In

addition, an automatic 10-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 Substitute Bill:

Business and Occupation Tax.
The substitute bill:
- creates nonrefundable credits for Class II and III railroads or other eligible taxpayers including credits equaling:
  - up to 50 percent of short line railroad maintenance costs but the credit not exceeding an amount equal to $5,000 multiplied by the number of miles of railroad track owned or leased in the state at the end of the year;
  - up to 100 percent of costs for new rail development not exceeding $2 million for each new rail development and caps the amount of credits claimed per year at $15 million; and
  - up to 100 percent of costs for modernization and rehabilitation expenditures;
- allows nonrefundable credits to be carried forward for up to five years;
- expands the definition of eligible taxpayers for nonrefundable credits to include railroads owned by a port, city, or county, or an owner or lessee of rail siding, industrial spur, or industry track located on or adjacent to a Class II or III railroad; and
- creates an exemption for Class I railroads for the fair market value of donated materials transferred to a Class II or III railroad or other eligible taxpayers.

Sales and Use Tax.
An exemption is created for materials required for track maintenance for Class II or III railroads or other eligible taxpayers. Other eligible taxpayers include railroads or rail facilities owned by a port, city, county, or an owner or lessee of rail siding, industrial spur, or industry track located on or adjacent to a Class II or III railroad.

Public Utilities Tax.
Nonrefundable credits are created for Class II and III railroads and other eligible taxpayers. This includes credits:
- up to 50 percent of short line railroad maintenance and may not exceed an amount equal to $5,000 multiplied by the number of miles of railroad track owned or leased in the state at the end of the year;
- up to 100 percent for new rail development and may not exceed $2 million for each new rail development and caps the amount of credits claimed per year at $15 million; and
- up to 100 percent for modernization and rehabilitation expenditures.

The nonrefundable credits may be carried forward for up to five years. Additionally, an exemption is created for Class I railroads for the fair market value of donated materials transferred to a Class II or III railroad or other eligible taxpayers.

A tax preference performance statement is included.

Substitute Bill Compared to Original Bill:

The substitute bill:
- removes the B&O tax exemption for Class I railroads for the value of products or gross receipts of sales of materials required for track maintenance;
- creates credit caps of $15 million annually using a first-in-time basis for the B&O tax and the PUT credits for new rail development;
- limits the carry forward period for the B&O tax and PUT credits to five years following the year the credit is earned;
- adds freight rail facility to the definition of eligible taxpayer for sales and use tax exemptions for materials required for track maintenance;
- changes the effective date to July 1, 2024; and
- makes technical changes, including adding definitions, clarifying intent behind the donation of materials, and changing expiration dates for certain sections.

Appropriation: None.

Fiscal Note: Available.

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

Staff Summary of Public Testimony:

(In support) Short line railroads are small businesses that employ hardworking and dedicated railroad workers who are dedicated to safely moving the freight that Washingtonians rely on every day. Short lines provide links for larger Class I and II railroads that move goods across the country. This bill would help short line railroads make crucial investments in their infrastructure and provide a funding mechanism for railroads to support economic development, expand capacity, and make safety improvements. This critical investment tool would help reduce greenhouse gas emissions associated with the freight rail transportation system by modernizing aging railroad infrastructure in the state. This bill requires the railroads to spend and invest their money first before receiving tax incentives. This bill will also encourage an increase in private investment in Washington's short line railroads and provide tax credits and exemptions for recycling and donating materials, which meets the state's recycling goals. State ports are also in support of this legislation, as the ports operate and rely on rail within the state.

After decades, if not a century, of neglect, many Washington short lines are modernizing their rail systems, but they need help. If railroads cannot get funding assistance and maintain their rail lines, customers that use their services might soon need to find alternative transportation services to move their goods. The other nine states with similar short line tax incentives claim it is the best highway preservation tool at their disposal. Freight rail moves over 250,000 carloads of traffic a year which is the equivalent of a million trucks on the road and saves the state more than $43 million dollars per year. Freight railroad is very capital intensive. A mile of new rail can cost upwards of $1 million. These incentives are needed and railroad track must be modernized and maintained.

(Opposed) None.

(Other) The ports require an amendment that adds rail facilities to the definition of eligible taxpayer so that the sections of port-owned rail can utilize the tax incentives offered in this bill. Ports spend significant amounts of money investing in rail infrastructure every year and would appreciate an addition to the definition.

Persons Testifying: (In support) Representative Andrew Barkis, prime sponsor; Cynthia Stewart, League of Women Voters of Washington; Eric Temple, Portland Vancouver Junction Railroad; Patrick Boss, Columbia Basin Railroad and Central Washington Railroad; Ross Lane, Puget Sound and Pacific Railroad; Jeff Van Schaick, Jaguar Transport Holdings; Ryan Pidde, Mickelson and Company Limited Liability Company; and Chris Herman, Washington Public Ports Association.

(Other) Adam LeMieux, Port of Everett.

Persons Signed In To Testify But Not Testifying: None.