Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Finance Committee

HB 1058

Brief Description: Providing incentives to improve freight railroad infrastructure.

Sponsors: Representatives Barkis, Leavitt, Corry, Fey, Connors, Simmons, Orcutt, Street, Griffey, Reed, Ybarra, Nance, Low, Bernbaum, Cortes, Springer, Santos, Ryu, Schmidt, Marshall, Jacobsen, Richards, Callan, Doglio, Timmons, Barnard, Berg, Salahuddin, Reeves and Donaghy.

Brief Summary of Bill

- Creates various business and occupation, public utility, and retail sales and use tax credits and exemptions for donated materials, maintenance, modernization, and new construction on short line railroad track.

Hearing Date: 1/28/25

Staff: Kristina King (786-7190).

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 $1.05 billion and are large operators that cover significant portions of the country. Class II railroads have an annual operating revenue between $47.3 million and $1.05 billion and are typically regional, midsize carriers. Class III railroads, also known as short lines, have an annual operating revenue of less than $47.3 million, are small and regional, typically move agricultural products, and are an average of 1-150 miles in length.

State Funding for 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. 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. During the 2023-25 biennium, requests for grants and loans in both programs exceeded available monies.

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. Businesses must pay the B&O tax even though they may not have any profits or may be operating at a loss.

A taxpayer may have more than one B&O tax rate, depending on the types of activities conducted. Major B&O tax rates are 0.471 percent for retailing; 0.484 percent for manufacturing and wholesaling; and 1.5 percent (businesses with taxable income of less than $1 million) or 1.75 percent (businesses with taxable income of $1 million or more) for services and for activities not classified elsewhere. There are many specialized B&O tax rates and preferential rates that apply to specific business activities.

In addition, a taxpayer may be eligible to utilize other tax preferences, including credits and deductions, to reduce their tax liability. For example, a taxpayer engaging in activities subject to different B&O tax rates may be eligible for a Multiple Activities Tax Credit. A taxpayer may also be eligible for a small business credit that will either eliminate or reduce their B&O tax liability. The credit is $160 per month for taxpayers that report at least 50 percent or greater of their total B&O taxable amount under service and other activities, real estate brokers, and contests of chance; the credit is $55 per month for all other businesses, multiplied by the number of months in the reporting period. The amount of the credit available phases out based on the business's gross receipts.

A business does not have to file an annual B&O tax return if the business does not owe other taxes or fees to the Department of Revenue (DOR) and has annual gross proceeds of sales, gross income, or value of products for all B&O tax classifications of less than $125,000 per year.

Public Utility Tax.
The gross income derived from the operation of publicly and privately owned utilities is subject to the public utility tax (PUT), unless otherwise exempt. The tax is imposed in lieu of B&O tax and is applied only on sales to consumers. Other income of the utility, such as retail sale of tangible personal property, is subject to the B&O tax. There are six different PUT rates,

depending on the specific utility activity. The rates are:
- 3.852 percent on telegraph companies, distribution of natural gas, and the collection of sewage;
- 3.8734 percent on the generation or distribution of electrical power;
- 0.642 percent on urban transportation and watercraft vessels under 65 feet in length;
- 1.926 percent on motor transportation, railroads, railroad car companies, and all other public service businesses;
- 5.029 percent on the distribution of water; and
- 1.3696 percent on log transportation.

A taxpayer who engages in one or more businesses subject to the PUT is fully exempt from the tax if their total gross income is $2,000 or less per a month. Any taxpayer that has a total gross income greater than $2,000 per month does not receive an exemption or deduction under this provision.

A business does not have to file an excise tax return for the PUT if the business does not owe other taxes or fees to the DOR and has annual gross proceeds of less than $24,000.

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 are not collected when the user acquires 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. The state sales and use tax rate is 6.5 percent; local sales and use tax rates vary from 0.5 percent to 4.1 percent, depending on the location.

Tax Preference Performance Statement.
Tax preferences confer reduced tax liability upon a designated class of taxpayers. These include tax exclusions, deductions, exemptions, preferential tax rates, deferrals, and credits. There are over 700 tax preferences, including a variety of sales and use tax exemptions. Legislation that establishes or expands a tax preference must include a Tax Preference Performance Statement (TPPS) that identifies the public policy objective of the preference, as well as specific metrics that the Joint Legislative Audit and Review Committee (JLARC) can use to evaluate the effectiveness of the preference. All new tax preferences automatically expire after 10 years unless an alternative expiration date is provided.

Summary of Bill:

Rail Expenditure B&O/PUT Credit.
Class II and class III railroads, and other eligible taxpayers, are allowed a B&O or PUT 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 $2,500 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 $500,000 per taxpayer each calendar year and is limited to an annual total credit cap amount of $8 million for all credits claimed by taxpayers in 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.

<u>Donated Materials B&O/PUT Credit</u>.
A company that recycles railroad material is allowed a B&O or PUT 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, ballasts, or other equipment that are part of the rail infrastructure removed from use on the main railroad line to be installed on tracks used by class II and class III railroads. The DOR must provide 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.

<u>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.

A null and void clause is included if specific funding is not provided for in the omnibus appropriations act by June 30, 2025.

<u>Tax Preference Performance Statement</u>.
A TPPS and JLARC review are included.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill contains multiple effective dates. Please see the bill.