SENATE BILL REPORT
ESHB 1371

As of March 21, 2023

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

Brief Description: Providing incentives to improve freight railroad infrastructure.

Sponsors: House Committee on Finance (originally sponsored by 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: Passed House: 3/16/23, 92-4.
Committee Activity: Business, Financial Services, Gaming & Trade: 3/23/23.

Brief Summary of 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 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 railroads:

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.

- 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—1400 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 one to 150 miles in length.

There are 27 short line railroads operating in Washington with over 1400 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—one 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. 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 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. 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 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.

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 to evaluate the efficacy of the tax preference. 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: 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 $5,000 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;
- 100 percent of the cost for new rail development, not to exceed $2 million per taxpayer each calendar year and not to exceed a total statewide limit of $15 million each calendar year; and
- 100 percent of the cost for railroad modernization and rehabilitation.

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.

Class I. A class I railroad, or an owner of a railroad material recycling company, 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.

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.

Credits may no longer be earned after January 1, 2035.

Retail Sales and Use Tax Exemption. The retail sales and use tax does not apply to sales of materials for track maintenance when purchased by a class II or class III railroad, or other eligible taxpayer. 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 in the state of 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, 2035.

Tax Preference Performance Statement. The bill includes a tax preference performance statement that states the Legislature intends to extend the tax preferences if a review finds that freight rail system in the state has been maintained or improved.

Appropriation: None.

Fiscal Note: Available. New fiscal note requested on March 16, 2023.

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

Effective Date: The bill contains several effective dates. Please refer to the bill.