Individual State Agency Fiscal Note

Bill Number: S 3942	Bill Title: AN ACT Relating to government incentives for improving freight railroad infrastructure	Agency: 140 Department of Revenue

Part I: Estimates

[ ] No Fiscal Impact

Estimated Cash Receipts to:

Fund	Fiscal Year 2024	Fiscal Year 2025	2023-2025 Total	2025-27 Biennium	2027-29 Biennium
GF-State Retail Sales Tax		(140,000)	(140,000)	(330,000)	(350,000)
GF-State Business and Occupation Tax		(900,000)	(900,000)	(7,200,000)	(7,200,000)
GF-State Public Utilities Tax		(900,000)	(900,000)	(7,200,000)	(7,200,000)
Total		(1,940,000)	(1,940,000)	(14,730,000)	(14,750,000)

Estimated Expenditures from:

	Fiscal Year 2024	Fiscal Year 2025	2023-2025 Total	2025-27 Biennium	2027-29 Biennium
FTE Staff Years	1.06	2.6	1.83	.9	.7
Fund					
GF-State 001	284,400	723,800	1,008,200	189,500	146,400
Total	284,400	723,800	1,008,200	189,500	146,400

The revenue and expenditures estimates on this page represent the most likely fiscal impact. Factors impacting the precision of these estimates, and alternate ranges (if appropriate), are explained in Part II.

Check applicable boxes and follow corresponding instructions:

[X] If fiscal impact is greater than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete entire fiscal note form Parts I-V.
[ ] If fiscal impact is less than $50,000 per fiscal year in the current biennium or in subsequent biennia, complete this page only (Part I).
[ ] Capital budget impact, complete Part IV.
[ ] Requires new rule making, complete Part V.

Legislative Contact:	**ALIA KENNEDY**	**Phone:**	**360-786-7405**	**Date:**	**1/16/2024**
Agency Preparation:	**BETH LEECH**	**Phone:**	**(360) 534-1513**	**Date:**	**1/16/2024**
Agency Approval	**Valerie Torres**	**Phone:**	**(360) 534-1521**	**Date:**	**1/17/2024**
OFM Review:		**Phone:**		**Date:**	

Part II: Narrative Explanation

II. A - Brief Description Of What The Measure Does That Has Fiscal Impact

Note: This fiscal note reflects language in draft legislation S-3942.1, 2024 Legislative Session.

CURRENT LAW:
Railroads pay public utility (PU) tax as public service businesses that engage in transportation in lieu of the business and occupation (B&O) tax. Railroads also pay retail sales and use tax to purchase materials required for track maintenance.

PROPOSAL:

BUSINESS AND OCCUPATION TAX CREDIT FOR SHORT LINE RAILROADS (section 2):
This section provides a B&O tax credit to qualified short-line railroads for qualified expenditures made by an eligible taxpayer. Credit issued and approved by the Department of Revenue (department) in one calendar year and not claimed in that calendar year may be carried forward for five additional calendar years.

Qualified expenditures may be used to generate a credit for the following amounts:
- Short-line railroad maintenance expenditures equivalent to 50% of the expenditures up to $3,500 multiplied by the miles of railroad track owned or leased in Washington at the close of the taxable year.
- New rail development equivalent to 50% of the expenditures.
- Modernization and rehabilitation to upgrade rail, switches, tracks, and bridges, equivalent to 50% of the expenditures.

The credits earned for railroad maintenance, new rail development, rail modernization, and rehabilitation products expenditures under this section and section 6 may not exceed $1 million for each taxpayer per year combined. The department must disallow any credits earned or portions thereof, that would cause the total amount of credits claimed under this section and section 6 of this bill to exceed, in the aggregate, $15 million in any calendar year.

The B&O tax credits may be transferred to any person subject to B&O tax. No new credits may be earned after December 31, 2035.

To claim or transfer a credit, the person applying must complete an application based on qualified expenditures incurred during the previous calendar year. The department must rule on applications within 60 days of receipt. It may extend the time of processing the application upon notice to the taxpayer and an explanation of why a ruling on the application cannot be completed within such time.

An eligible taxpayer is any railroad subject to B&O tax and classified by the United States Surface Transportation Board as a class II or class III railroad, any railroad owned by a port, city, or county in the state, or any 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.

Qualified expenditures do not include those used to generate a federal tax credit or expenditures funded by a state or federal grant.

This credit does not apply to class I railroads or short-line railroads owned by a class I railroad or any of its subsidiaries.

No credit may be earned after January 1, 2036, and no credit may be claimed on tax returns filed for reporting periods beginning on or after January 1, 2042.

BUSINESS AND OCCUPATION TAX CREDIT FOR RAILROAD MATERIAL RECYCLERS (section 3):

This section provides a B&O tax credit for companies that recycle railroad materials if the company transfers to an eligible taxpayer rail, ties, tie plates, joint bars, fasteners, switches, ballast, or other equipment or materials that are part of the rail infrastructure to be installed on tracks used by class II and III railroads. The credit is equal to the fair market value of the donated materials.

Materials must be given to a qualifying recipient without consideration. The department must provide in a rule a standard for determining the fair market value of donated materials.

Credit earned in one calendar year and not claimed in that calendar year may be carried forward for five additional calendar years.

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

The B&O tax credit may be transferred to any person subject to B&O tax. No credit transfer applications may be submitted for materials donated after December 31, 2036. No new credits may be earned after January 1, 2037, and no credit may be claimed on tax returns filed for reporting periods beginning on or after January 1, 2042.

RETAIL SALES AND USE TAX EXEMPTION (sections 4 and 5):
These sections exempt from sales and use tax materials required for track maintenance 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 the state, or any owner or lessee of rail siding, industrial spur, or industry track located on or adjacent to the railroad.

Sellers making tax-exempt sales must obtain an exemption certificate from the buyer.

Materials required for track maintenance are defined as rails, ties, tie plates, joint bars, fasteners, switches, ballast, subgrade, roadbed, bridges, industrial leads, sidings, signs, safety barriers, crossing signals and gates, and track when used for the purpose of track maintenance.

These sections expire January 1, 2036.

PUBLIC UTILITY TAX CREDIT FOR SHORT LINE RAILROADS (section 6):
This section provides a PU tax credit to qualified short-line railroads for qualified expenditures made by an eligible taxpayer. Credit earned in one calendar year and not claimed in that calendar year may be carried forward for five additional calendar years.

Qualified expenditures may be used to generate a credit for the following amounts:
- Short-line railroad maintenance expenditures equivalent to 50% of the expenditures up to $3,500 multiplied by the miles of railroad track owned or leased in Washington at the close of the taxable year.
- New rail development equivalent to 50% of the expenditures.
- Modernization and rehabilitation to upgrade rail, switches, tracks, and bridges, equivalent to 50% of the expenditures.

The credits earned for railroad maintenance, new rail development, rail modernization, and rehabilitation products expenditures under this section and section 2 may not exceed $1 million for each taxpayer per year combined. The department must disallow any credits earned, or portions thereof, that would cause the total amount of credits claimed under this section and section 2 of this bill to exceed, in the aggregate, $15 million in any calendar year.

The PU tax credits may be transferred to any person subject to PU tax. No new credits may be earned after December 31, 2035.

To claim or transfer a credit, the person applying must complete an application based on qualified expenditures incurred during the previous calendar year. The department must rule on applications within 60 days of receipt. It may extend the time of processing the application upon notice to the taxpayer and an explanation of why a ruling on the application cannot be completed within such time.

An eligible taxpayer is any railroad subject to PU tax and classified by the United States Surface Transportation Board as a class II or class III railroad, any railroad owned by a port, city, or county in the state, or any 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.

Qualified expenditures do not include those used to generate a federal tax credit or expenditures funded by a state or federal grant.

This credit does not apply to class I railroads or short-line railroads owned by a class I railroad or any of its subsidiaries.

No credit may be earned after January 1, 2036, and no credit may be claimed on tax returns filed for reporting periods beginning on or after January 1, 2042.

PUBLIC UTILITY TAX CREDIT FOR RAILROAD MATERIAL RECYCLERS (section 7):
This section provides a PU tax credit for companies that recycle railroad materials if the company transfers to an eligible taxpayer rail, ties, tie plates, joint bars, fasteners, switches, ballast, or other equipment or materials that are part of the rail infrastructure to be installed on tracks used by class II and III railroads. The credit is equal to the fair market value of the donated materials.

Materials must be given to a qualifying recipient without consideration. The department must provide in a rule a standard for determining the fair market value of donated materials.

Credit earned in one calendar year and not claimed in that calendar year may be carried forward for five additional calendar years.

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

The PU tax credit may be transferred to any person subject to PU tax. No credit transfer applications may be submitted for materials donated after December 31, 2036. No new credits may be earned after January 1, 2037, and no credit may be claimed on tax returns filed for reporting periods beginning on or after January 1, 2042.

EFFECTIVE DATE:
The retail sales and use tax exemptions take effect July 1, 2024.

The B&O and PU tax credits for railroad material recyclers take effect July 1, 2025.

The B&O and PU tax credits for short-line railroads take effect January 1, 2025.

II. B - Revenue Impact

ASSUMPTIONS:
- There are 25 short-line railroads that may qualify for the credits and exemptions in this proposal.

- Washington State Department of Transportation provides legislative grant and loan funding for freight rail investments through a biennial call for projects. Current information on those programs assumes $8 million in grants and $5 million in loans will be provided during the 2023-25 Biennium. The loans require a minimum 20% match.
- Short-line railroad expenditures in future biennia are similar to planned expenditures in the 2023-2025 biennium.
- Short-line railroads have over 1,400 miles of track in Washington.
- For this estimate, it is assumed that materials represent 50% of the total cost of track maintenance.
- For this estimate, it is assumed that track maintenance occurs annually.
- Track maintenance costs, on average, are significantly higher than $3,500 per mile of track; therefore, this estimate assumes the B&O and PU tax credits for qualified short-line railroad maintenance expenditures will be limited to $3,500 per mile of track.
- Since no specific B&O tax exemption exists for sales of transferable B&O or PU tax credits, it is assumed that such sales will qualify as taxable events under the B&O tax. It will be taxed at the service and other activities tax rate. Given that no data is available to estimate the transfer or sale of these credits in Washington, the revenue impact to the state general fund from any B&O taxes collected due to these sales is unknown.
- The impacts from the B&O and PU tax credits for railroad material recyclers are confidential, as those credits impact fewer than three taxpayers. These tax credits result in additional negative revenue impacts not shown in this fiscal note.
- Sales tax growth mirrors the growth rate in the ERFC November 2023 forecast.
- The average local sales tax rate is 2.95%.
- The department receives the taxes from monthly taxpayers the month after the business collects the sales tax from the consumer. Most local tax distributions occur the month after the department receives sales and use taxes that businesses collect. This leads to a one-month delay in revenues for the state and a two-month delay in revenues for local jurisdictions.
- The sales and use tax exemptions are effective July 1, 2024, and impact 11 months of state sales and use tax collections in fiscal year 2025 and 10 months of local sales and use tax collections in fiscal year 2025.
- The B&O and PU tax credits for short-line railroads, as estimated, assume credit applications will be received on or after January 1, 2025, for qualified expenditures in the previous calendar year. It is assumed the first credits will be approved and used in March 2025, impacting three months of collections in fiscal year 2025.
- The B&O and PU tax credits for railroad material recyclers are effective July 1, 2025, and impact 11 months of collections in fiscal year 2026.

DATA SOURCES:
- U.S. Surface Transportation Board
- TrainWeb.com
- American Society of Civil Engineers, Infrastructure Report Card
- U.S. Department of Transportation, Federal Railroad Administration
- Department of Transportation, Washington State Rail Plan 2019-2040
- Department of Transportation, Washington 2023-2025 Freight Rail Assistance Program/Freight Rail Investment Bank project lists
- Assessment of State Support for Short Line Rail Infrastructure, Report to the Washington State Joint Transportation Committee, December 2021
- Economic and Revenue Forecast Council, November 2023 forecast
- Department of Revenue, excise tax returns

REVENUE ESTIMATES:
This bill decreases state revenues by an estimated $1.9 million in the 11 months of impacted collections in fiscal year 2025, and by $7.4 million in fiscal year 2026, the first full year of impacted collections.

This bill also decreases local revenues by an estimated $59,000 in the 10 months of impacted collections in fiscal year 2025, and by $74,000 in fiscal year 2026, the first full year of impacted collections.

TOTAL REVENUE IMPACT:

State Government (cash basis, $000):
FY 2024 - $ 0
FY 2025 - ($ 1,940)
FY 2026 - ($ 7,360)
FY 2027 - ($ 7,370)
FY 2028 - ($ 7,370)
FY 2029 - ($ 7,380)

Local Government, if applicable (cash basis, $000):
FY 2024 - $ 0
FY 2025 - ($ 59)
FY 2026 - ($ 74)
FY 2027 - ($ 77)
FY 2028 - ($ 79)
FY 2029 - ($ 82)

II. C - Expenditure Impact

ASSUMPTIONS:
- This bill affects approximately 25 taxpayers.
- The annual tax performance report is not required. The tax preference performance statement (section 8) of this bill lists the purpose as a general purpose as indicated in RCW 82.32.808 (2) (f).

FIRST YEAR COSTS:
The department will incur total costs of $284,400 in fiscal year 2024. These costs include:

Labor Costs - Time and effort equate to 1.06 FTE.
- Set up, program and test computer systems for multiple new credits. This includes a new credit ID and associated return processing and system indicator codes, a new e-file worksheet, and modifications to reports and data files.
- Gather requirements, attend implementation meetings, document and test system changes due to new credits.
- Create a Special Notice and identify publications and information the department may need to create or update on the department's website.

Object Costs - $130,000.
- Computer system changes, including contract programming.

SECOND YEAR COSTS:
The department will incur total costs of $723,000 in fiscal year 2025. These costs include:

Labor Costs - Time and effort equate to 2.6 FTEs.
- Adopt one new administrative rule.
- Continue computer system testing, monitoring, and maintenance.
- Assist taxpayers with reporting questions and respond to inquiries via email, web message, and paper correspondence.
- Process returns, verify credits taken, and process all associated work items, including issuing assessments for return errors and underpayments.
- Create a Special Notice and identify publications and information the department may need to create or update on the department's website.

Object Costs - $389,900.
- Computer system changes, including contract programming.

ONGOING COSTS:
Ongoing costs for the 2025-27 biennium equal $189,500 and include similar activities described in the second-year costs. Time and effort equate to 0.9 FTE.

Part III: Expenditure Detail

III. A - Expenditures by Object or Purpose:

	Fiscal Year 2024	Fiscal Year 2025	2023-2025 Total	2025-27 Biennium	2027-29 Biennium
Salaries and Wages	98,100	213,100	311,200	123,800	95,400
Benefits	32,500	70,400	102,900	40,800	31,400
Personal Service Contracts	130,000	389,900	519,900		
Supplies & Material	16,300	35,800	52,100	19,300	15,200
Office Equipment	7,500	14,600	22,100	5,600	4,400
Total	284,400	723,800	1,008,200	189,500	146,400

III. B - FTE Detail:

Job Classification	Salary	FY 2024 FTEs	FY 2025 FTEs	2023 - 2025 Total	2025 - 2027	2027 - 2029
EMS BAND 4	131,684		.01	.01		
EMS BAND 5	153,836		.01	.01		
EXCISE TAX EX 3	64,092		.9	.45	.75	.6
IT B A-JOURNEY	91,968	.3	.8	.55	.15	.1
IT B A-SR/SPEC	101,376	.1	.1	.1		
IT SYS ADM-JOURNEY	96,552	.4	.5	.45		
MGMT ANALYST4	76,188		.01	.01		
TAX POLICY SP 2	78,120	.18	.12	.15		
TAX POLICY SP 3	88,416	.07	.12	.1		
TAX POLICY SP 4	95,184		.01	.01		
WMS BAND 2	98,456	.01	.01	.01		
WMS BAND 3	111,992		.01	.01		
Total		1.06	2.6	1.86	.9	.7

III. C - Expenditures by Program (optional):

	Fiscal Year 2024	Fiscal Year 2025	2023-2025 Total	2025-27 Biennium	2027-29 Biennium
Total					

Part IV: Capital Budget Impact

None.

Part V: New Rule Making Required

OFM Form FN (10/95)

Should this legislation become law, the department will use the standard process to adopt WAC 458-20-XXX, a new rule on railroad tax exemptions and credits. Persons affected by this rulemaking would include certain railroads.

Revenue Impact Detail

			First Biennium		Second Biennium		Third Biennium	
FUND	SOURCE	CODE	1st YEAR	2nd YEAR	3rd YEAR	4th YEAR	5th YEAR	6th YEAR
GF-State	Retail Sales Tax	0101		(140,000)	(160,000)	(170,000)	(170,000)	(180,000)
GF-State	Business and Occupation Tax	0105		(900,000)	(3,600,000)	(3,600,000)	(3,600,000)	(3,600,000)
GF-State	Public Utilities Tax	0135		(900,000)	(3,600,000)	(3,600,000)	(3,600,000)	(3,600,000)
Total				(1,940,000)	(7,360,000)	(7,370,000)	(7,370,000)	(7,380,000)
OTHER								
Total								
Net				(1,940,000)	(7,360,000)	(7,370,000)	(7,370,000)	(7,380,000)

Revenue Impact - by Biennium

FUND	SOURCE	CODE	1st Biennium	2nd Biennium	3rd Biennium
GF-State	Retail Sales Tax	0101	(140,000)	(330,000)	(350,000)
GF-State	Business and Occupation Tax	0105	(900,000)	(7,200,000)	(7,200,000)
GF-State	Public Utilities Tax	0135	(900,000)	(7,200,000)	(7,200,000)
Total			(1,940,000)	(14,730,000)	(14,750,000)
OTHER					
Total					
Net			(1,940,000)	(14,730,000)	(14,750,000)