



Analysis of Original Bill

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Sponsor:

Bill Number: AB 1397

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Related Bills: See Legislative
History

Subject: Railroad Construction Tax Credit

Summary

This bill would, under the Personal Income Tax Law (PITL) and Corporation Tax Law (CTL), allow a credit for qualified railroad reconstruction or replacement expenses.

Recommendation – No position.

Reason for the Bill

The reason for the bill is to stimulate the reconstruction or replacement of antiquated railroad infrastructure, ensure railroad safety, and create overall positive and sustained economic impacts, by providing a tax incentive to railroad owners.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and would be specifically operative for taxable years beginning on or after January 1, 2020, and before January 1, 2025.

Federal/State Law

Federal law allowed, during taxable years beginning after December 31, 2004, and before January 1, 2018, the Railroad Track Maintenance Credit that was 50 percent of the qualified railroad track maintenance expenditures paid or incurred by an eligible taxpayer.¹ The amount was limited to \$3,500 multiplied by the sum of the number of miles of railroad track owned or leased by the eligible taxpayer as of the close of the

¹ Eligible taxpayer was any Class II or Class III railroad, and any person who transported property using the rail facilities of a Class II or Class III railroad or who furnished railroad-related property or services to a Class II or Class III railroad.

taxable year, and the number of miles of railroad track assigned to the taxpayer by a Class II or Class III railroad which owned such track.² “Qualified Railroad Track Maintenance Expenditures” was defined as gross expenditures (whether or not otherwise chargeable to capital account) for maintaining railroad track, including roadbed, bridges, and related track structures, owned or leased as of January 1, 2015, by a Class II or Class III railroad. The basis of the track was required to be reduced by the amount of credit allowed.

There are currently no state credits comparable to the credit this bill would create.

This Bill

This bill would, under the PITL and CTL, for taxable years beginning on or after January 1, 2020, and before January 1, 2025, allow a tax credit of 50 percent of the qualified taxpayer’s qualified railroad reconstruction or replacement expenditures.

The amount of credit would be limited to the amount in the following calculation: \$3,500 multiplied by the number of miles of railroad track owned or leased within the state by the qualified taxpayer at the taxable year end.

The bill would define “qualified railroad reconstruction or replacement expenditures” as the costs paid or incurred by the qualified taxpayer for:

- Reconstruction or replacement of railroad infrastructure, including, but not limited to, track, roadbed, bridges, industrial leads, and track-related structures owned or leased by the qualified taxpayer as of January 1, 2020.
- New construction of industrial leads, switches, spurs and sidings, and extensions of existing sidings.

The bill would define “qualified taxpayer” as a company that owns a Class II or Class III railroad (as defined by the United States Surface Transportation Board).

The credit could be carried forward for up to five years from the year in which the credit was incurred, or until exhausted, whichever occurs first.

² The assignment was limited to once per taxable year of the Class II or Class III railroad.

As uncodified law, this bill would require the following performance measures be provided to the Franchise Tax Board (FTB) by the taxpayer:

- A specific list of improvements and the number of miles improved.
- A time line specifying when the taxpayer will be 286K capable.³
- A list of improvements made only as a result of this credit.
- An explanation of the market failure that this credit attempts to correct.

The FTB could prescribe rules, guidelines, or procedures necessary or appropriate to carry out the purposes of the credit, except as otherwise provided.

This bill would exempt the FTB's rules, guidelines, or procedures from the requirements of the Administrative Procedure Act.

Implementation Considerations

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

The goals, objectives, and reporting requirements under Section 41 are uncodified law that could lead to disputes with taxpayers and complicate the administration of this bill.

The defined term "qualified railroad reconstruction or replacement expenditures" lacks an in-state requirement thus, the credit would be allowed for otherwise qualifying expenditures paid or incurred either inside or outside California. Further, the credit would be allowed without regard to the underlying asset being placed in service. If this is contrary to the author's intent, this bill should be amended.

Legislative History

None.

Other States' Information

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

³ Able to accommodate heavier-weight railcars (i.e., loaded car weights of 286,000 pounds, or "286K"). Class I railroad standard, adopted in 1994. (Source: 2018 California State Rail Plan)

Florida, Illinois, Massachusetts, Michigan, and Minnesota do not allow credits or deductions for railroad expenditures. New York allows an exemption from income and franchise tax for railroad redevelopment corporations.

Fiscal Impact

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified.

Economic Impact

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB1397 as Introduced February 22, 2019. Assumed Enactment after June 30, 2019.

(\$ in Millions)

Fiscal Year	Revenue
2020-2021	-\$2.0
2021-2022	-\$4.9
2023-2024	-\$5.6

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

Based on federal data on the amounts of the federal Railroad Track Maintenance Credit, it is assumed that the total amount of credit for federal purposes would be approximately \$240 million for taxable year 2020.⁴ Based on the data published by the U.S. Department of Transportation and the California Department of Transportation, about three percent of the total qualified railroad track are located in California resulting in approximately \$7 million in credit generated by California taxpayers.

⁴ Internal Revenue Code section 45G was operative for taxable years beginning on or after December 31, 2004, and before January 1, 2018.

It is estimated that 80 percent, including the S corporation adjustment, or \$6.5 million, would have a tax liability to offset with the credit. Of that amount, 70 percent, or \$4.5 million, would claim the credit in the year generated and the remaining credit would be used over the subsequent five years.

The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the amounts reflected in the above table.

Policy Concerns

Conflicting tax policies result when a credit is provided for an item that is already deductible as a business expense or is depreciable. Providing both a credit and allowing the full amount to be deducted would have the effect of providing a double benefit for that item.

The credit percentage and the credit limitation is equal to those in the recently expired federal credit for railroad track maintenance. In general, a taxpayer's federal income tax liability is significantly higher than its state income tax liability. As a result, a state tax credit equal in amount to a federal credit could be considered to provide a greater proportionate benefit for state tax purposes than for federal tax purposes.

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