F I S C A L I M P A C T R E P O R T

		ORIGINAL DATE	1/28/22		
SPONSOR	Diamond/Hemphill	**LAST UPDATED**	2/7/22	**HB**	
SHORT TITLE	Short Line Railroad Modernization Tax Credit			**SB**	106
				ANALYST	Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY22	FY23	FY24	FY25	FY26		
	($4,000.0)	Indeterminate; only five class 3 railroads are eligible			Recurring	General Fund (PIT/CIT)

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY22	FY23	FY24	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	$5.2	$0	$5.2	Nonrecurring	TRD - ITD
	$6.4	$0	$6.4	Recurring	TRD - RPD
	Reports an impact			Recurring	NMDOT/Railroad Bureau

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD) – Revised Analysis
Department of Transportation/Railroad Bureau (DoT/RB)
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

Senate Bill 106 creates a new personal income tax credit and a corresponding corporate income tax credit for short line railroad modernization. The credits are allowed a taxpayer who is an owner of eligible railroad that incurs qualified reconstruction or replacement expenditures or qualified new infrastructure expenditures for the maintenance, reconstruction, replacement or new construction of short line railroad track in New Mexico. The amount of credit is set at 50% of eligible expenditures, with a cap on credit amounts of $5,000 per rail mile for renovation and rebuilding projects and $500 thousand per "rail-served customer projects" for new construction. An eligible railroad is one that is defined as a Class two or Class three railroad by the federal

Surface Transportation Board. A Class two railroad has operating revenues of between $40.5 million and $270 million and owns and operates at least 350 miles of track. Class three railroads are typically short line railroads serving a few towns or hauling cars for other railroads. Often these short line railroads are former branch lines of larger railroads or railroads that operate over abandoned tracks.

There is no effective date of this bill. It is assumed that the effective date is 90 days following adjournment of the Legislature (May 18, 2022). The provisions of the bill are applicable to taxable years beginning on or after January 1, 2022.

FISCAL IMPLICATIONS

Estimating the cost of tax expenditures is difficult. The general fund cost depends on uptake. If no taxpayers adopt the supported activities, then is would be not cost. After the fact, confidentiality requirements surrounding certain taxpayer information create uncertainty and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

TRD has submitted the following discussion about possible utilization of this credit.

> "According to the New Mexico Department of Transportation (DOT), there are no Class II railroads in New Mexico. There are five Class III railroads which according to the Surface Transportation Board are those having an annual carrier operating revenue of $40.4 million or less after applying the revenue deflator formula. According to industry representatives, there is a planned investment of $8 million, which would result in a $4 million tax credit. This information cannot be independently verified by Tax & Rev and it is assumed to only have an impact in FY23."

DOT has concerns that Class 3 railroad owners may have to forfeit federal tax credits if these owners claim the state tax credits. This would significantly affect any fiscal impact of this bill.

EDD has an interesting perspective regarding the underlying policy:

> "The Economic Development Department (EDD) is unable to estimate the cost of the credit. The credit is unusually expensive, at roughly twice the value of the film production tax credit on a percentage of expenditures basis, and significantly greater than the myriad of tax expenditures that provide a partial or complete gross receipts tax deduction. This credit gives private industry the decisions of what expenditures to make on which rail lines but makes the state an equal partner for the cost."
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> "The credit is uncapped, so the total cost to the state of the credit depends on the number of reconstruction or new construction projects. This could be zero or significant as there is no way to estimate that amount of line that needs to be reconstructed or the amount of new construction projects that could occur. This creates difficulty forecasting the amount of credits that could be paid out in a given fiscal year, increasing uncertainty for general fund revenues."

SIGNIFICANT ISSUES

DOT has indicated significant concern with provisions of this bill. These concerns will be repeated in the TECHNICAL IMPLICATIONS section.

> "One of the two eligible types of project for the tax credit is "qualified reconstruction or replacement expenditures". These are defined as "gross expenditures for maintenance, reconstruction or replacement of railroad infrastructure, including track, roadbed, bridges, industrial leads, sidings and track-related structures owned or leased by an eligible railroad in New Mexico." SB 106 excludes from this definition expenditures used to qualify for a federal tax credit. Section 45G of Title 26 of the United States Code allows Class 2 and Class 3 railroads to claim a tax credit for "qualified railroad track maintenance expenditures" that has essentially the same definition as that used for "qualified reconstruction or replacement expenditures" in SB 106. SB 106 thus appears to prohibit railroad owners from claiming a tax credit in New Mexico for expenditures for maintenance, reconstruction or replacement of railroad infrastructure unless they forego claiming a federal tax credit for these expenditures."

This may be national standard legislation. It closely duplicates Oklahoma Administrative Code §710:59-15-103. Mississippi, Oregon, Wisconsin, Kansas and other states have provided state support for short line railroad modernization.

Wikipedia[1] lists the following six class III railroads in New Mexico. The New Mexico Central Railroad might be defunct. This would bring the total to the five Class III railroads noted by DOT. Alternatively, the Escalante Western Railroad has been abandoned with the closure of the Escalante Power Plant in late 2020. Plans have been announced, however, by EscalanteH2 partners to develop the abandoned Escalante Power Plant as a hydrogen hub with on-site use of hydrogen to generate peak electric power.

The **Arizona Eastern Railway is** Class III railroad that operates 265 miles (426 km) of railroad between Clifton, Arizona, and Miami, Arizona, with approximately 40 miles within New Mexico between Lordsburg, New Mexico, and Bowie, Arizona.

The **New Mexico Central Railroad** was newly created around 2017 to take over Southwestern Railroad's lease interest in a line from Rincon, New Mexico (in Doña Ana County) to Deming, New Mexico – 116 miles of rail total. This line may be defunct.

The **Southwestern Railroad** is a Class III railroad operating since 1990, and until 2017 consisted of two unconnected railroad sections in New Mexico, with no shared functions. These and a third section in the Texas panhandle and Oklahoma, now closed, all operated separately. Since January 2017, only the Whitewater Division is operated by Southwestern.

The **Texas & New Mexico Railway** is a class III short-line railroad operating in west Texas and southeast New Mexico. The railroad line operates on 111 miles of track from a connection with the Union Pacific at Monahans, Texas, and terminates at Lovington, New Mexico. The railroad primarily provides freight service for the oilfields and related industries in the region.

[1] https://en.wikipedia.org/wiki/List_of_New_Mexico_railroads

Escalante Western Railway is a subsidiary of the Western Fuels Association. ESWR's sole purpose is to haul coal between Escalante Jct. (east of Gallup, New Mexico) and Peabody Coal Company's Lee Ranch Mine north of Grants, New Mexico. In January 2020, Tri-State Electrical Co-Op, the owner of the Escalante Generating Station announced the closure of the power plant by the end of 2020.[1] With this announcement, the lone customer of the Escalante-Western Railway evaporated, and the final load of coal left the El Segundo Coal Mine for the Generating Station on April 29, 2020.

The **Navajo Mine Railroad** is an electrified private railroad operated by BHP in New Mexico, USA, within the Navajo Nation. It operates 13.8 miles (22.2 km) of track between the Four Corners Generating Station and Navajo Coal Mine (formerly owned by BHP). The railroad does not have any connection to the national rail network.

Neither the Cumbres and Toltec steam railroad nor the Chili Line – tourist line from Santa Fe to Lamy are listed as eligible for these tax credits.

EDD extends its comments included above in FISCAL IMPLICATIONS:

> "The tax credit is intended to increase the amount of usable short line rail throughout the state. This could increase the number of rail-served business and industrial parks and sites across the state, making it easier to compete for business location projects that need rail access, which is an oft-cited requirement. These projects would lead to additional investment and job creation."
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> "This will also undoubtedly increase the volume of construction projects, which in turn will increase the number of construction workers. According to the federal Bureau of Labor Statistics (BLS), the number of establishments, workers and their annual wages is so small for the short line rail industry that it cannot be shared due to privacy concerns. This indicates the industry around the state is small. By increasing the amount of short line rail in the state, it is safe to assume that the number of workers in that industry will increase. According to a draft economic impact analysis in 2018, completed by Mickelson & Company, LLC, direct employment upon passage of this bill would increase by 100 jobs."
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> "By increasing the amount of short line rail in the state, ancillary businesses like warehousing, could see a boost in employment. The same draft economic impact analysis produced by Mickelson & Company, LLC, states the 100 direct employees will support an additional 360 indirect jobs."

TRD notes that the provisions of this bill add a tax incentive to the extensive list of PIT and CIT credits already in statute.

> "While the use of tax incentives may support particular industries or encourage specific social and economic behaviors, the proliferation of such incentives complicates the tax code. Adding more tax incentives: (1) creates special treatment and exceptions to the code, growing tax expenditures and/or narrowing the tax base, with a negative impact on the general fund; and, (2) increases the burden of compliance on both taxpayers and Tax & Rev. Adding complexity and exceptions to the tax code does not comport generally with the best tax policy."

> "The credit does not include a purpose statement or a sunset date. Tax & Rev supports sunset dates for policymakers to review the impact and intention of a credit before extending it, if a sufficient timeframe is allotted for tax incentives to be measured. Given the current unknown fiscal impact of this credit, a sunset date would force an examination of the benefit of this credit versus the cost."

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the credit and other information to determine whether the credit meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

TRD reports moderate administrative impact, with a caveat:

"Updates to GenTax and Taxpayer Access Point (TAP) will be necessary to add this new credit. Tax & Rev will update forms, instructions, and associated publications. These updates will be incorporated into annual tax program revisions."

"Implementing this credit will have a low impact on Tax & Rev's Information Technology Division (ITD) requiring approximately 100 hours of effort or approximately 1 month for an estimated staff workload cost of $5,164."

"To improve the administration of the credit, the flow of certification data to Tax & Rev is imperative. If DOT is not able to share certification data electronically with Tax & Rev at the time of certification, a Full Time Employee (FTE) may be required to take on the additional workload in Tax & Rev's Revenue Processing Division (RPD). Currently, all certifications must be entered manually, so increasing the number of claims with a new credit would increase the administrative workload for Tax & Rev. However, the assumed low number of potential claimants can be absorbed by RPD. Nonrecurring costs are approximately 200 hours of workload at a cost of $6,400."

"Tax & Rev expects to be able to absorb the impact of these changes, as outlined in this standalone bill, with no additional FTE. However, if several bills with similar effective dates become law there will be a greater impact to Tax & Rev and additional FTE or contract resources may be needed to complete the changes specified by the effective date(s) of each bill."

DOT/RB also reports a potential impact.
"SB 106 would require NMDOT to establish procedures for and subsequently administer a program to both certify eligibility of specific projects for the tax credit and determine the amount of tax credit allowed for each project. Neither of these responsibilities is something that NMDOT currently undertakes. NMDOT would have to either hire new staff or train existing staff to administer a program that both determines the eligibility of projects for receiving a tax credit and the amount of credit allowed for the project."

TECHNICAL ISSUES

DOT/RB has significant concerns on provisions of this bill:

"One of the two eligible types of project for the tax credit is "qualified reconstruction or replacement expenditures". These are defined as "gross expenditures for maintenance, reconstruction or replacement of railroad infrastructure, including track, roadbed, bridges, industrial leads, sidings and track-related structures owned or leased by an eligible railroad in New Mexico." SB 106 excludes from this definition expenditures used to qualify for a federal tax credit. Section 45G of Title 26 of the United States Code allows Class 2 and Class 3 railroads to claim a tax credit for "qualified railroad track maintenance expenditures" that has essentially the same definition as that used for "qualified reconstruction or replacement expenditures" in SB 106. SB 106 thus appears to prohibit railroad owners from claiming a tax credit in New Mexico for expenditures for maintenance, reconstruction or replacement of railroad infrastructure unless they forego claiming a federal tax credit for these expenditures."

TRD notes several technical issues:
"Sections 1(D) and 2(D) allow for the credit certificate of eligibility to be sold, exchanged or transferred. Tax & Rev recommends clarifying language stating that the credit upon transfer of the certificate is subject to the same requirements as the original credit for the tax years it can be applied to."

"There is a timeline for when a credit can be claimed but not for when the taxpayer must apply for the credit. There is precedence for including a deadline for an application in other credits such as Solar Market Development Tax Credit. Tax & Rev recommends adding a timeline specifying when the deadline to apply for the credit."

"To have all relevant information, it is important to receive taxpayer certification data in a timely manner. Tax & Rev recommends adding authority to share information with DOT under Section 7-1-8.8 NMSA 1978. A Memorandum of Understanding may be required to facilitate data exchange prior to implementation. Tax & Rev recommends adding language that requires electronic information sharing for certificates awarded by DOT. Receiving electronic files of awarded certificates data improves return processing efficiency and accuracy and supports annual reporting. The advantages of electronic data processing include speed, efficiency, reduced labor, accuracy and reduced costs. It allows for process automation that significantly reduce, if not eliminate, time delays associated with manual processing."

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date. In many similar proposals over the years for tax incentives and state support, the Legislature establishes an annual cap on total expenditures. Because of the uncertainties regarding uptake of this credit, it might be appropriate to establish an annual cap on this proposed credit.

POSSIBLE QUESTIONS

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.

5. Accountability: Preferences should be easy to monitor and evaluate.

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.
4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

LFC Tax Expenditure Policy Principle	**Met?**	**Comments**
Vetted	✗	Although this may be national standard legislation, the proposal has not be debated in New Mexico
Targeted		The bill does not establish a purpose, set long-term goals nor sets measureable targets.
Clearly stated purpose	✗	
Long-term goals	✗	
Measurable targets	✗	
Transparent	✓	The bill requires TRD to report utilization data annually. However, TRD would not have access to other information required to judge the merits of the tax credit.
Accountable		The uptake of this proposed credits is uncertain. It might be appropriate to establish an expiration date and set a cap on total annual tax credits.
Public analysis	✗	
Expiration date	✗	
Effective		Because no entity has announced plans to modernize any of the five (or six) class III short line railroads, it is difficult to assert that the bill has any effect.
Fulfills stated purpose	✗	
Passes "but for" test	✗	
Efficient	✗	The federal grant support may be sufficient to incentivize railroad modernization and the proposed state tax credits may not yield any additional efforts.
Key: ✓ Met ✗ Not Met ? Unclear		

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