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## FISCAL IMPACT REPORT

<b>SPONSOR</b> <u>Diamond/Correa Hemphill</u>	<b>LAST UPDATED</b> <u>2/7/23</u>
	<b>ORIGINAL DATE</b> <u>1/30/23</u>
<b>SHORT TITLE</b> <u>Rail Infrastructure Tax Credits</u>	<b>BILL NUMBER</b> <u>Senate Bill 221</u>
	<b>ANALYST</b> <u>Graeser</u>

### REVENUE\* (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY23	FY24	FY25	FY26	FY27		
	0.0	Up to \$12,000.0**	Up to \$12,000.0**	Up to \$12,000.0**	Recurring	General Fund (PIT/CIT)

Parenthesis ( ) indicate revenue decreases.

\*Amounts reflect most recent version of this legislation.

\*\* See TECHNICAL ISSUES for discussion whether the \$6 million cap is combined for CIT and PIT claims or cumulative.

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT\* (dollars in thousands)

FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
<b>\$5.5</b>		\$0	\$5.5	Nonrecurring	TRD - ITD
	\$2.3	\$0	\$2.3	Nonrecurring	TRD - RPD
Reports an impact				Recurring	NMDOT/Railroad Bureau

### Sources of Information

LFC Files  
FIR for 2022 SB106

### Responses Received From

Department of Transportation (NMDOT) -- Transit and Rail  
Taxation and Revenue Department (TRD)  
Economic Development Department (EDD)

## SUMMARY

### Synopsis of Senate Bill 221

Senate Bill 221 grants to owners of Class II or Class III railroads both personal and corporate income tax credits equal to fifty percent of the eligible railroad's qualified expenditures up to a maximum credit of \$5,000 per mile of track owned or leased by the railroad in New Mexico, or \$1 million for each new rail served customer project. A railroad's cumulative tax credit for serving new rail customers is capped at \$5 million per year. The certification for these credits is done by the Department of Transportation (DOT), which agency may certify a maximum of \$6 million per calendar year. A corresponding credit is also created in the Corporate Income and Franchise Tax Act and may have a separate and additional \$6 million cap.

SB221 requires taxpayers seeking a tax credit pursuant to the bill to apply for a certificate of eligibility from NMDOT after the completion of the short line railroad track project. After NMDOT determines a taxpayer meets the requirements for claiming the tax credit, NMDOT may issue to that taxpayer a certificate of eligibility that includes the amount of tax credit allowed pursuant to this bill.

The certificate of eligibility may be submitted with the taxpayer's return or sold, exchanged, or otherwise transferred to another taxpayer. Taxation and Revenue Department (TRD) must be notified within 10 days of any sale, exchange, or other transfer of the certificate of eligibility. Applications for a tax credit must be submitted to TRD, along with the certificate of eligibility, within 12 months following the calendar year in which the qualified expenditures are incurred. SB221 mandates TRD to compile an annual report of these credits for presentation to the Revenue Stabilization & Tax Policy Committee and LFC with an analysis of the cost of the credits and whether the tax credits are fulfilling the intended purpose.

This bill does not contain an effective date, and as a result, would go into effect June 16, 2023, (90 days after the Legislature adjourns) if signed. The income tax credits are applicable to tax years beginning January 1, 2023. Projects must be completed and credits earned in taxable years prior to January 1, 2034.

## 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 there would be no cost. After the fact, confidentiality requirements surrounding certain taxpayer information create uncertainty. 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 or benefits of tax expenditures.

The \$5 million annual limit in Section 1 (B) applies to each claimant taxpayer. The total amount of PIT and CIT credits are separately limited to \$6 million per calendar year per tax program. However, it may be that the \$6 million cap might be for total of PIT and CIT credits taken together, however, that should be clarified with an amendment.

TRD's analysis, however, reports that the total CIT and PIT credits taken together are capped at \$6 million. In practice, most shortline railroads would be organized as Subchapter C corporations and would report and pay corporation income taxes. However, there is a plethora of pass-through entity types, such as limited liability partnerships or Subchapter S corporations that would render the railroad applicable eligible to claim credit pursuant to the personal income tax provisions.

In its 2022 analysis of SB106, TRD submitted the following discussion about possible utilization of this credit.

According to the New Mexico Department of Transportation (NMDOT), 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 TRD and it is

assumed to only have an impact in FY23.

NMDOT/transit and rail has concerns about the administration of these credits and their assigned role in approving these credits. This concern is further explored in the ADMINISTRATIVE IMPLICATIONS section.

... SB221 excludes expenditures used to qualify for a federal tax credit as being eligible for a New Mexico tax credit. 26 U.S. § 45G provides for a railroad track maintenance tax credit, which allows Class II and Class III 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 SB221. It is not clear whether the intention is for NMDOT to determine whether the railroad has requested a federal tax credit as part of its process to issue a certificate of eligibility, or whether TRD would make this determination after the railroad submits its application for a tax credit. If this is a NMDOT responsibility, it would require NMDOT to have access to each railroad’s documents requesting the federal tax credit, which may require receiving and reviewing the railroad’s federal tax return. If this is a TRD responsibility, undertaken only after the tax credit is applied for, TRD would need access to the railroad’s documents requesting a federal tax credit, and there is the potential that TRD’s review may determine a certificate of eligibility that has been sold, exchanged, or otherwise transferred to another taxpayer may not be eligible for a tax credit to the taxpayer that submits it.

In its review of 2022 SB106, Economic Development Department (EDD) provided the following perspective on the underlying policy:

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.

## SIGNIFICANT ISSUES

This may be national model 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.

There are up to six Class III railroads in New Mexico.<sup>1</sup> The New Mexico Central Railroad might be defunct. Additionally, 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](#).

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<sup>1</sup> [https://en.wikipedia.org/wiki/List\\_of\\_New\\_Mexico\\_railroads](https://en.wikipedia.org/wiki/List_of_New_Mexico_railroads)

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.

**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. 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 comments:

The tax credit is intended to increase the amount of usable 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.

The bill is likely to increase the number of construction workers around the state. This will likely lead to an increase in personal income taxes and gross receipts.

The bill would allow the credit to be transferred, exchanged or sold. Transferrable credits nearly always have the same cost to the state as a refundable credit but provide less benefit to the intended recipient. It is a far less efficient and effective way of incentivizing the desired activity. This either leads to less desired activity at the same cost or a higher cost to the state for the same amount of activity as would be achieved with a refundable credit.

The bill places a cap of \$6 million dollars on the credit that is allowed to be certified but

does not let other taxpayers know if the credit has been reached. The bill calls for the taxpayer to apply for the credit following the completion of the expenditures. This may create issues with companies not knowing if they will be awarded the credits when they have spent the money. It essentially removes the certainty component for businesses to plan out construction projects.

In its review of 2022 SB106, Economic Development Department (EDD) noted the following:

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.

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

While 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 TRD. Adding complexity and exceptions to the tax code does not comport generally with the best tax policy.

The credit has a defined end date to claim the tax credit and thus a sunset date. TRD supports sunset dates for policymakers to review the impact of tax expenditures before extending them.

## **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 is meeting its purpose. TRD would accomplish this reporting by including this tax credit in its annual edition of the Tax Expenditure Report.

## **ADMINISTRATIVE IMPLICATIONS**

SB221 would require NMDOT 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 NMDOT currently

undertakes, nor are they within the expertise of the NMDOT.

SB221 would require NMDOT 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.

This bill will have minimal impact on TRD.

TRD will need to make information system changes and update forms, instructions and publications. Staff training to administer the credit will need to take place.

TRD's Administrative Services Division (ASD) will be required to test credit sourcing and perform other systems testing. It is anticipated this work will take approximately 40 hours split between 2.0 Full-Time Equivalent (FTE) of a pay band 70 and a pay band 80 at a cost of approximately \$2,300.

This bill will have a low impact on TRD's Information Technology Division (ITD), approximately 100 hours or about 1 month for an estimated staff workload cost of \$5,554.

TRD expects to be able to absorb the impact of these changes, as outlined in this standalone bill, however, if several bills with new tax credits become law there will be a greater impact to TRD and additional FTE will be required to process additional credit claims.

## **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

NMDOT notes two issues:

SB221 is nearly identical to and substantively the same as HB208.

Additionally, SB221 creates a state tax credit that essentially replicates the federal tax credit found in 26 U.S. § 45G.

EDD notes:

Companion to HB208- Language in the bills, page 5 line 25, needs to be reconciled. SB 221 states: "that are owned" and in HB208 states: "owned".

## **TECHNICAL ISSUES**

LFC staff note that the \$6 million annual cap applies separately to claims filed for personal income tax (PIT) and to those filed for corporate income tax (CIT). If this is not the intent, then an amendment would be in order.

LFC staff also note that there is no provision in the case that claims exceed the cap amounts. Are claims extinguished, or are they rolled over to the following period?

NMDOT indicated significant concern with provisions of this bill.

... SB221 excludes expenditures used to qualify for a federal tax credit as being eligible for a New Mexico tax credit. 26 U.S. § 45G provides for a railroad track maintenance tax

credit, which allows Class II and Class III 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 SB221. It is not clear whether the intention is for NMDOT to determine whether the railroad has requested a federal tax credit as part of its process to issue a certificate of eligibility, or whether TRD would make this determination after the railroad submits its application for a tax credit. If this is a NMDOT responsibility, it would require NMDOT to have access to each railroad’s documents requesting the federal tax credit, which may require receiving and reviewing the railroad’s federal tax return. If this is a TRD responsibility, undertaken only after the tax credit is applied for, TRD would need access to the railroad’s documents requesting a federal tax credit, and there is the potential that TRD’s review may determine a certificate of eligibility that has been sold, exchanged, or otherwise transferred to another taxpayer may not be eligible for a tax credit to the taxpayer that submits it.

TRD reports a number of technical issues:

In Sections 1 and 2, Part A, page 1, line 19, and page 6, line 11, state, “...a taxpayer that is a railroad...” This is not clear and should specify whether it refers to a taxpayer that owns a railroad.

In Sections 1 and 2, Part B, the amount of credit is outlined. It is unclear if those limits are on each project or if the taxpayer can file in subsequent tax years for amounts exceeding the limits for the tax year/calendar year. A limit in the timeframe the taxpayer must apply for the credit, as outlined below would clarify this.

Section (B)(1) sets the amount of the credit at \$5,000 “multiplied by the by the number of miles of railroad track owned or leased in the state by the taxpayer...” It is not clear whether “leased ... by” means track leased by the taxpayer to another person, or leased by the taxpayer from another person.

In Section (B)(2), “rail-served customer project” is not defined, and its meaning is not clear.

In sections 1 and 2, Part C, the taxpayer is directed to apply after the completion of the project, but there is no deadline outlined. A deadline would help understand what is possibly out in terms of credits not applied for and certified. An example would be ‘shall apply for a certificate of eligibility from the department of transportation after completion of but no more than one year after the completion of the maintenance, reconstruction, replacement or new construction of railroad track infrastructure in New Mexico for which qualified reconstruction or replacement expenditures or qualified new rail infrastructure expenditures are made to determine if the taxpayer is eligible to receive the tax credit provided by this section.’

In Sections 1 and 2, Part D, the requirements for the certificate include it be numbered, the date of issuance, and the amount of the credit; however, TRD recommends also including the tax year that they certificate is eligible for.

In Sections 1 and 2, Part F, the restriction there is to apply the certificate and essentially claim the credit within 1 year from the end of the calendar year when the expenditures

occurred; however, the certification has to take place *after* the completion of the projects which may leave some expenditures ineligible. Suggested language would be, ‘F. To receive a tax credit provided by this section, a taxpayer shall apply to the department on forms and in the manner prescribed by the department within twelve months following the calendar year in which the ~~qualified expenditures are incurred~~ certificate was issued.’

In Section 1, Part J, and Section 2, Part H, the reporting requirements may want to include DOT and include the information on the certification process as well.

Section 1, Part K refers to ‘gross expenditures’. It is unclear how ‘gross expenditures’ differ from ‘expenditures’.

While Section 1, Part H makes provision for taxpayers to claim the credit through a partnership structure, there is no equivalent provision in Section 2, and therefore a corporation that is a partner in a partnership that meets the requirements to claim the credit will not be able to claim the credit. As corporations are often partners in partnerships, Section 2 should be brought in line with Section 1, Part H. (For comparison, see Section 7-2A-28.1(J) NMSA 1978, the 2021 Sustainable Building Tax Credit, which does provide for corporations that are partners of a qualifying partnership to claim that credit.)

In its review of 2022 SB106, TRD noted several additional technical issues:

Sections 1(D) and 2(D) allow for the credit certificate of eligibility to be sold, exchanged or transferred. TRD 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.

To have all relevant information, it is important to receive taxpayer certification data in a timely manner. TRD recommends adding authority to share information with NMDOT under Section 7-1-8.8 NMSA 1978. A Memorandum of Understanding may be required to facilitate data exchange prior to implementation. TRD recommends adding language that requires electronic information sharing for certificates awarded by NMDOT. 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.

## OTHER ISSUES

TRD recommends adding the following language to Section 2 to receive certificates from DOT: The Department of Transportation shall provide the taxation and revenue department appropriate certification information for all eligible taxpayers to whom certificates are issued to in a secure manner on regular intervals agreed upon by both taxation and revenue department and department of transportation.

## POSSIBLE QUESTIONS

<b>Does the bill meet the Legislative Finance Committee tax policy principles?</b>	
1. <b>Adequacy:</b> Revenue should be adequate to fund needed government services.	
2. <b>Efficiency:</b> Tax base should be as broad as possible and avoid excess reliance on one tax.	
3. <b>Equity:</b> Different taxpayers should be treated fairly.	
4. <b>Simplicity:</b> Collection should be simple and easily understood.	
5. <b>Accountability:</b> Preferences should be easy to monitor and evaluate	
<b>Does the bill meet the Legislative Finance Committee tax expenditure policy principles?</b>	
1. <b>Vetted:</b> 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. <b>Targeted:</b> The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.	
3. <b>Transparent:</b> The tax expenditure requires at least annual reporting by the recipients, the Taxation and Revenue Department, and other relevant agencies.	
4. <b>Accountable:</b> 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. <b>Effective:</b> 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. <b>Efficient:</b> The tax expenditure is the most cost-effective way to achieve the desired results.	

LFC Tax Expenditure Policy Principle	Met?	Comments
<b>Vetted</b>	✓	Proposed last year as SB106; may be national model legislation adopted by other jurisdictions
<b>Targeted</b> Clearly stated purpose Long-term goals Measurable targets	✗ ✗ ✗	None stated
<b>Transparent</b>	✓	Report required
<b>Accountable</b> Public analysis Expiration date	✗ ✗	
<b>Effective</b> Fulfills stated purpose Passes “but for” test	✗ ✗	None stated Duplicates federal credit
<b>Efficient</b>	✗	Allows a private entity unlimited opportunity to decrease state revenues.
Key:    ✓ Met    ✗ Not Met    ? Unclear		