State of Oklahoma
Incentive Evaluation Commission
Evaluation: Railroad Modernization Tax Credit

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PFM Group Consulting LLC
BNY Mellon Center
1735 Market Street
42nd Floor
Philadelphia, PA 19103

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Incentive Overview

Available since 2006, Oklahoma's Railroad Modernization Tax Credit is equal to 50 percent of qualified railroad reconstruction or replacement expenditures incurred by a Class II or Class III railroad.[1] The amount of the credit is limited to $5,000 per mile of railroad track owned or leased within the State by the taxpayer. The total amount of credits used to offset tax liability is limited to $5 million per year.

Recommendation: Retain with Modifications.

Key Findings

- **Smaller railroads play an important role in Oklahoma.** Class III railroads account for approximately one-third of the state's 3,200-mile rail network. These smaller railroads operate in rural areas not served by larger Class I railroads – particularly the southwestern and southeastern areas of the state.

- **Rail service is essential to Oklahoma economy.** According to one 2021 study, rail-related employment in the state totaled more than 27,000 jobs in 2019, and the $1.3 billion earned by these employees represented more than 1 percent of Oklahoma's total labor income. The combined value-added impact of rail-related activity amounted to nearly $2.6 billion and represented approximately 1.3 percent of the state's Gross State Product (GSP). Rail-related industries generated an estimated $5.7 billion in output, in terms of total revenue.[2]

- **Train accidents/incidents have generally declined over the past decade, both nationally and in Oklahoma.** While it is likely that the impacts of the COVID-19 pandemic on rail activity contributed to the lower number of accidents/incidents, the reduction in Oklahoma (-5.6 percent annually, 2013-2019) outpaced the national average (-1.7 percent annually).

- **Freight rail is an extremely capital-intensive industry, and the private owners are responsible for their own maintenance and improvement projects.** Most smaller railroads operate on legacy infrastructure suited for lighter weight railcars that must be upgraded to handle today's heavier, industry standard railcars. Compared with other major modes of transportation, railroad owners invest one of the highest percentages of revenues (19 percent) to maintain and add capacity to their system, spending nearly $25 billion annually.[3]

- **Oklahoma's Class III railroads have a significant need for infrastructure improvements.** Freight rail needs and opportunities identified in the State Rail Plan include updates to accommodate heavier railcars and reduction of bottlenecks, among others. External analyses confirm that investments in the state's freight rail network are needed: the American Society of Civil Engineers' (ASCE) most recent Report Card for Oklahoma's Infrastructure found that segments of the short line network could not accommodate the high-capacity freight cars common to Class I railroads. Further, while the short line industry generally had the resources to maintain basic operations, increasingly higher funding would be required to maintain operations in accordance with escalating industry standards.[4]

[1] 68 O.S. § 2357.104
[2] ODOT, "Oklahoma State Rail Plan," (2021). Accessed electronically at https://oklahoma.gov/content/dam/ok/en/odot/publications/SRP%202021%20Final%20with%20FRA%20Approval.pdf
[3] AAR, "Railroad 101," (last updated June 2023). Accessed electronically at https://www.aar.org/wp-content/uploads/2020/08/AAR-Railroad-101-Freight-Railroads-Fact-Sheet.pdf
[4] American Society of Civil Engineers – 2013 Report Card for Oklahoma's Infrastructure. Accessed electronically at https://www.infrastructurereportcard.org/wp-content/uploads/2016/10/ASCE-OK-2013-Report-Card.pdf

- **In recent years, statutory changes have modified the program to the benefit of eligible taxpayers.** In 2020, SB 1322 increased the credit amount from $2,000 per mile to $5,000 per mile; added certain types of projects to the list of qualified expenditures; eliminated a 25 percent reduction in the calculated credit amount; increased the annual credit cap from $2 million to $5 million; and extended the sunset date to January 1, 2030.

- **Credit use to reduce tax liability fluctuates from year to year but is declining on a per-claim basis.**[5] As shown in the following table, between 2017 and 2021, an average of 10 returns per year reduced overall tax liability among claimants by an average of approximately $2.4 million. On a per-return basis, this equates to an average of just over $270,000. Generally, the average reduction in liability is declining over the period in question.

Table 1: Tax Credit Activity, TY 2017-2021 ($ in Millions) *

	Total Returns	Carry Forward**	Credit Established During TY	Total Amount Claimed	Tax Liability Reduced	Avg. Claim per Return	Avg. Reduction in Liability
2017	15	$2.0	$1.4	$3.3	$1.3	$220,569	$88,009
2018	8	$0.5	$2.3	$2.8	$2.5	$343,925	$308,673
2019	12	$1.9	$1.9	$3.7	$2.4	$310,955	$202,211
2020	7	$0.0	$3.3	$3.3	$3.1	$465,851	$439,040
2021	9	$0.0	$2.9	$2.9	$2.9	$325,252	$320,273
Avg.	**10.2**	**$0.9**	**$2.3**	**$3.2**	**$2.4**	**$333,310**	**$271,641**

Source: Oklahoma Tax Commission
** Average Claim per Reward and Average Liability Reduction totals are real values, not in $ millions.*
*** Carry forward represents unused credit carried over from prior year(s).*

- **The tax incentive results in increased statewide economic activity, but the net impact is negative.** Between 2017 and 2021, the program, through direct, indirect, and induced economic effects, generated approximately $1.0 in State tax revenue. Over the same time, however, the state provided nearly $11.7 million in tax credits, resulting in a net impact over the time period of -$10.7 million, as shown in the following table.

Table 2: Impact Summary

	Credits Established During Tax Year	Estimated Oklahoma Tax Revenue	Net Impact
2017	$1,350,101	$112,651	($1,237,450)
2018	$2,289,957	$195,727	($2,094,230)
2019	$1,879,679	$162,699	($1,716,980)
2020	$3,257,815	$285,566	($2,972,249)
2021	$2,893,040	$256,810	($2,636,230)
Total	**$11,670,592**	**$1,013,454**	**($10,657,138)**

Source: PFM IMPLAN analysis output, September 2023

- **Relative to states with comparable tax credits, the dollar value of Oklahoma's is relatively generous.** Ten states have enacted tax credit incentives like Oklahoma's, and several others have attempted to enact or are considering their own programs. At $5,000 per track mile owned or leased, Oklahoma – in addition to Arkansas, Kansas, Mississippi, and Missouri – has among the highest cap. Other states match the federal cap of $3,500, and the lowest cap is $1,000 in Oregon.

[5] Program usage totals reflect the impacts of some of the statutory changes cited, though isolating and accurately allocating the impacts of those changes is difficult, if not impossible. Other, external factors may contribute to overall program activity, including inflationary concerns, economic uncertainty, rising construction costs, global supply chain issues, and more.

- **The State is not currently at risk of significant increases in expenditures associated with the program.** Given the implementation of a $5 million annual cap, the State is not at risk of significant increases in expenditures related to this incentive.

Recommendations

- **Consider making credits refundable instead of transferable.** Critics of transferrable tax credits question whether it is prudent for tax breaks to be sold to companies in industries the tax credits were not meant to incent. Additionally, selling the credits generally deflates their value, as they are typically sold by those companies at 85 to 90 cents on the dollar. Instead of making credits transferrable, it may be more impactful to make them refundable. Refundable credits provide a larger benefit to the original recipient at the same cost to the State, as these taxpayers would not sell them for less than full value.

- **Standardize reporting to improve data collection and analysis.** The data the Office of Management and Enterprise Services (OMES) publishes on the State's data and statistics website, while useful, is difficult to summarize and analyze because there is no consistent identifier for unique taxpayers. To analyze credits claimed by taxpayers, one must use the taxpayer's name, which may or may not be consistent. For example, Wal-Mart made three claims associated with this credit between FY2017 and FY2021; the records use two variations of the business name: "WAL-MART STORES INC" and WAL-MART STORES EAST, LP." Data must be cleaned and streamlined carefully and thoroughly before it can be used. This manual manipulation of the data increases the possibility of human error.

- **To evaluate program success, require eligible recipients to provide additional information about eligible projects.** To understand the full economic impact of the tax credit program and resulting improved transportation infrastructure, data regarding total eligible expenditures – as well as whether an eligible project was linked to an economic development project (retention or expansion) – would be required. Given the Oklahoma Department of Transportation's (ODOT) role in administering certain aspects of the program, it may be best suited to collect such information.

Introduction & Project Background

Incentive Evaluation Commission Overview

The Oklahoma Incentive Evaluation Commission (Commission) was created by HB 2182 in 2015 to conduct objective evaluations of the State of Oklahoma's wide array of business incentives. The Commission is made up of five appointed voting members along with ex officio representatives of the Department of Commerce, Office of Management and Enterprise Services, and Tax Commission.

Under the enabling legislation, each of the State's economic incentives must be evaluated once every four years according to a formal set of general criteria, including (but not limited to) economic output, fiscal impact, return on investment, and effectiveness of administration, as well as criteria specific to each incentive as determined by the Commission.

Since the Commission's inception, it has contracted with PFM Group Consulting LLC (PFM) to serve as the independent evaluator of each incentive scheduled for review in that year. PFM issues a final report on each incentive with recommendations as to how Oklahoma can most effectively achieve the incentive's goals, including recommendations on whether the incentive should be retained, reconfigured, or repealed; as well as recommendations for any changes to State policy, rules, or statutes that would allow the incentive to be more easily or conclusively evaluated in the future.

The Commission considers the independent evaluator's findings and recommendations – as well as all public comments – before voting to retain, repeal, or modify the recommendations for each incentive under review. It then submits a final report to the Governor and the Legislature.

Summary of 2019 Evaluation Findings and Recommendations

In accordance with the four-year evaluation cycle described in the preceding, the Railroad Modernization Tax Credit was first reviewed by the Commission in 2019.[6] Significant findings and recommendations from PFM's evaluation of the program are summarized in the following table:

Table 3: Summary of 2019 Evaluation Findings and Recommendations

	Finding(s)
Findings	
Overall Findings	– Rail service is essential to Oklahoma's economy and provides a multitude of additional benefits – There appears to be a need for additional private investment in Class III railroad tracks – In the years following the implementation of the credit, short line derailments have decreased – Nationally, state support for short line railroads is typically offered in the form of tax-based incentives and/or through grant or loan programs – Evaluations of similar short line tax credit programs are generally positive, but have yielded mixed results

[6] The 2019 Tax Incentive Evaluation Report is available on the Commission's website at https://iec.ok.gov/sites/g/files/gmc216/f/IEC2019FinalReport.pdf

	Finding(s)
Fiscal & Economic Impact	– Credit use to reduce tax liability fluctuates from year to year – The tax credit program results in increased statewide economic activity, but the net impact is negative – Credits are frequently transferred by railroad companies to other taxpayers – A few beneficiaries make up a large majority of total claimants – most of which are not railroad companies – Several changes have impacted the value of and ability to claim the credit in recent years
Future Fiscal Impact Protections	– The State is not currently at risk of significant increases in expenditures associated with the program
Administrative Effectiveness	– There are concerns about the tax data and reporting, but improvements are being made
Recommendations	
Retain, Reconfigure, or Repeal	– Retain
Other Recommendations	– Consider making credits refundable instead of transferable – Standardize reporting to improve data collection and analysis – To evaluate program success, require eligible recipients to provide additional information about eligible projects

Source: State of Oklahoma Incentive Evaluation Commission, Tax Incentive Evaluation Report 2019

Based on PFM's analysis and consideration of other factors, the Commission voted 4-0 to approve PFM's recommendations to retain the program.[7]

In 2020, SB 1322 made the following substantive changes, all effective November 1, 2020):[8]

- Increased the credit amount from $2,000 per mile of track owned or leased to $5,000 per mile for tax years 2020 and onward.
- Modified the definition of "qualified railroad reconstruction or replacement expenditures" to include expenditures for track maintenance, natural disasters, and crossings.
- Eliminated the 25 percent reduction in calculated credit amount (which had been in place since January 1, 2016).
- Increased the annual credit cap from $2 million to $5 million, beginning in tax year 2020.
- Added a sunset date of January 1, 2025 (previously, none was included in statute). Subsequently, SB 17X of the First Extraordinary Session of 2023 extended the sunset date to January 1, 2030.

2023 Criteria and Evaluation Approach

A key factor in evaluating the effectiveness of incentive programs is to determine whether they are meeting the stated goals as established in state statute or legislation (where applicable) and as noted previously, the provisions of HB 2182 require that criteria specific to each incentive be identified and used for the evaluation.

The purpose of the Railroad Modernization Tax Credit is not articulated in the enabling legislation, though it is reasonable to assume that the intent is to encourage investment in the state's short line railroads. The Commission has adopted the following criteria to assist in a determination of program effectiveness:

[7] In addition, the Commission also voted to include comments provided by a representative from the Oklahoma Railroad Association in the Commissioner's Comments section of its report.
[8] In addition to these substantive changes, SB 1322 also made minor modifications to the program statute, including deleting obsolete language and eliminating specified taxpayer elections and related prohibitions.

- Program usage, including types of projects funded by the program.
- New business activity associated with the railroad improvements.
- Private investment associated with the improvements funded by the credits.
- Railroad safety associated with the program.
- State return on investment.

To conduct its 2023 review of the Railroad Modernization Tax Credit, the PFM undertook several project tasks, including (but not limited to) the following:

- Reviewed and analyzed qualitative and quantitative data, including information from the Oklahoma Tax Commission (OTC) and ODOT.
- Conducted subject matter expert and internal stakeholder interviews.
- Met with leadership from the State, Oklahoma City, and Tulsa Chambers of Commerce and interested industry representatives.
- Benchmarked Oklahoma to other states.

Industry Background

Brief History of the U.S. Freight Rail Network

Railroads were critical to the development of early America, providing a vehicle for previously inaccessible areas to be developed, for products to get to market, and for the developed and undeveloped areas of the nation to be linked together. The railroad industry grew rapidly in the years leading up to World War I. From 1833 to 1860, the total miles of rail track in operation in the U.S. grew from 380 to more than 30,000. By 1917, 1,500 U.S. railroads operated approximately 254,000 miles of track and employed 1.8 million people – more than any other industry.

Following the war, growing competition from highways and waterways and increasingly stringent federal regulation greatly impacted the industry, and the Great Depression impacted it further: rail industry revenue fell by 50 percent from 1928 to 1933. By 1937, more than 70,000 miles of railroad (30 percent of all track miles) were in receivership. Between 1944 and 1949, rail traffic declined by 28 percent. Most railroads were in financial trouble, and federal regulations often prevented railroads from discontinuing money-losing passenger routes. Throughout the 1950s and 1960s, the construction of the interstate highway and inland waterway systems and ongoing losses in passenger operations led to increased railroad bankruptcies, service abandonments and deferred maintenance.

The Rail Passenger Service Act of 1970 relieved freight railroads of most of the losses incurred on the passenger side, but freight rail conditions continued to deteriorate. Bankrupt railroads accounted for more than one in five track miles, and operational railroads lacked the funds to properly maintain their tracks. By 1976, more than 47,000 miles of track had to be operated at reduced speeds because of unsafe conditions.

Federal regulations were often cited as a key factor in the rail industry's decline. In 1978, the U.S. Department of Transportation noted "the current system of railroad regulation…is a hodgepodge of inconsistent and often anachronistic regulations that no longer correspond to the economic condition of the railroads, the nature of intermodal competition or the often-conflicting needs of shippers, consumers and taxpayers."

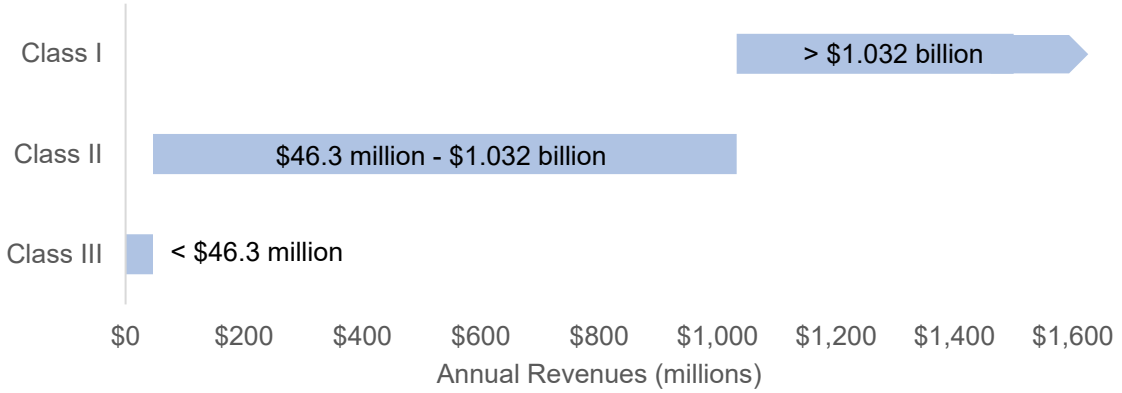
The Staggers Rail Act of 1980 reduced federal control over rail freight operations and recognized the need for railroads to earn adequate revenues to support their operations. Among other changes, the Act provided railroads with the freedom to set rail rates based on demand and to enter into confidential contracts while streamlining the procedures for abandoning or selling unneeded rail lines. The result was increased competition that stimulated advances in technology and a restructuring of the industry, including the creation of hundreds of new, smaller railroads around the United States.

The National Freight Rail Network Today

The Federal Railroad Administration (FRA) estimates that the current national freight rail network consists of more than 600 individual railroads encompassing nearly 140,000 route miles. The U.S. Surface Transportation Board (STB) designates each of these railroads as Class I, II, or III based on annual operating revenues, as illustrated in the following figure:[9]

[9] To account for inflation, the STB calculates 'deflator factors' to adjust railroad annual operating revenues to 2019 levels. The railroad revenue deflator formula is based on the Railroad Freight Price Index developed by the Bureau of Labor Statistics. Using the deflator factors, the STB can determine the annual revenue threshold for classification purposes. The income thresholds shown are for 2022, the most recent year for which deflator factors have been calculated. A railroad is reclassified when its revenues are above or below the threshold for three consecutive years.

Figure 1: Annual Revenue Thresholds by Railroad Class, 2022



Source: U.S. Surface Transportation Board

Today, there are seven Class I railroads operating in North America that focus primarily on transporting freight and cargo.[10] Notably, due to their size, railroads in this category are held to high regulatory standards and must submit reports to the STB detailing financial and operating statistics, including employment and traffic data.

Class II and III railways are collectively known as 'short line' and/or 'regional' railroads. An estimated 630 short line railroads operate over approximately 45,000 route miles (approximately one-third of the total national rail network) in 49 states. Some just a few miles long and others stretching hundreds of miles, these smaller railways work in partnership with Class I railroads to provide what is often referred to as 'first and last mile' service (i.e., the first and/or often final link between suppliers and customers). Short line rail service connects much of the country – particularly small towns and rural areas – to the national rail network.

Short lines serve every industry, but are particularly critical for energy, agriculture, and manufacturing. These railroads safely move commodities such as crude oil, ethanol, and coal to address the nation's energy needs. Nationally, short line railroads handle one in five cars moving annually at origin or destination, providing service to over 10,000 customers.

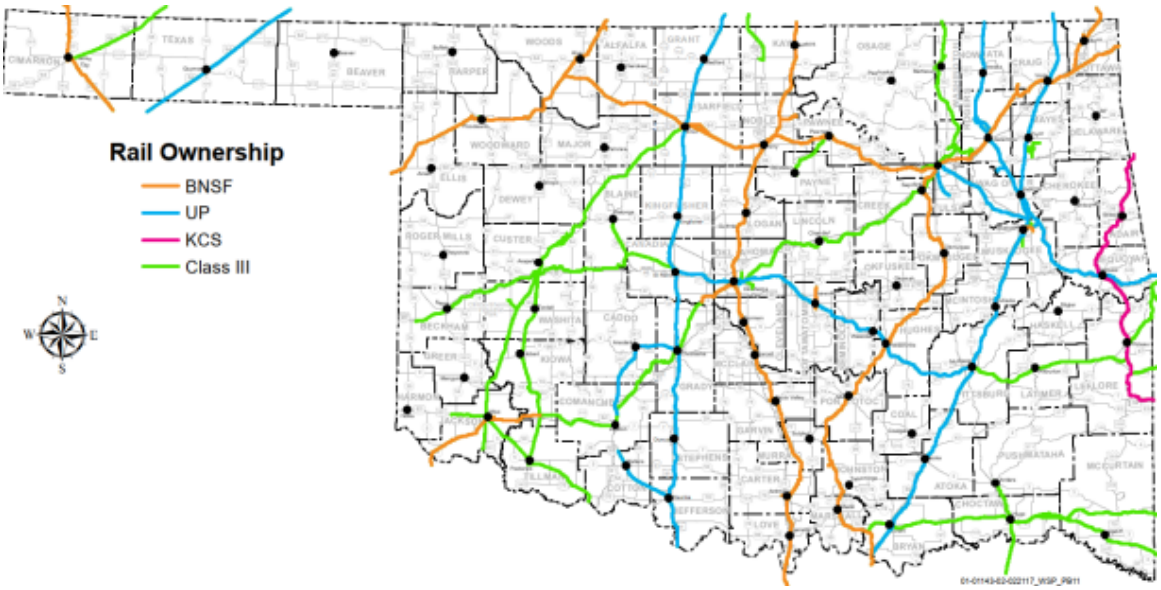
Using the network to transport goods is considered by many to be both affordable and reliable – and the continued optimizing of operations over time has resulted in greater rail capacity, reliability, and productivity across the rail network. Efficiency and productivity gains that improve the cost-effectiveness of rail also benefit rail customers. The affordability of freight rail saves rail customers billions of dollars each year and enhances the global competitiveness of U.S. products. According to the American Association of Railroads, average rail rates (measured by inflation-adjusted revenue per ton-mile) are approximately 40 percent lower than they were in 1980, indicating that the average rail shipper can move much more freight for the same price paid more than four decades ago.[11] In addition, the freight rail network offers ancillary benefits that other modes of transportation do not, including reductions in road congestion, highway fatalities, fuel consumption, greenhouse gases, cost of logistics, public infrastructure maintenance costs, and more.

[10] Amtrak is the only Class I railroad primarily focused on passenger transportation. Amtrak operates over a 21,400-mile network, 70 percent of which is owned by other railroads (referred to as 'host track').
[11] AAR, "Freight Rail and the Staggers Act of 1980: The Turning Point for Railroads." Accessed electronically at https://www.aar.org/issue/staggers-act/#:~:text=Since%20the%20Staggers%20Rail%20Act,more%20than%2040%20years%20ago.

Oklahoma's Short Line Railroads

The State of Oklahoma is home to three Class I rail lines and 18 Class III lines. Major rail providers are Union Pacific and Burlington Northern Santa Fe (BNSF). As shown on the following map, Class III railways operate in rural areas not served by Class I railroads – particularly the southwestern and southeastern corners of the state.

Figure 2: Oklahoma's Rail Network



Source: ODOT (2022)

As shown in the following table, Oklahoma's rail network consists of more than 3,200 route-miles (excluding leases and trackage rights).[12] Class I railroads comprise more than 2,000 route-miles in the state (two-thirds of total route miles), with Class III railroads accounting for approximately the other one-third. Consistent with national trends, nearly all Class III route-miles (and all Class I route-miles) are privately owned and operated (the State owns 136 operational miles).

Table 4: Oklahoma Route-Miles by Class and Ownership

	Route-Miles Owned	% of All Route-Miles
Class I	**2,012**	**62.0%**
BNSF Railway	966	29.8%
Union Pacific Railroad (UP)	894	27.5%
Kansas City Southern (KCS)	152	4.7%
Class III	**1,234**	**38.0%**
Private	1,041	32.1%
State of Oklahoma	193	5.9%
Total	**3,246**	**100.0%**

Source: Oklahoma Long Range Transportation Plan: 2020-2045

[12] Oklahoma has no Class II railroads.

Industry Employment and Economic Impacts

Rail service is essential to Oklahoma's economy. A 2019 study of the economic impacts of rail in Oklahoma estimated the following:[13]

- **Employment:** Economic impacts of rail extended beyond the 1,400 individuals directly employed in the provision of rail transportation (both passenger and freight). When the freight rail transportation and visitor impact activities and multiplier impacts were included, rail-related employment in Oklahoma in 2019 amounted to 27,121 jobs, which represented 1.2 percent of the 2.3 million statewide employment.

- **Employment Income:** $1.3 billion earned by these employees represented 1.1 percent of Oklahoma's total labor income in 2019. Labor income includes employee compensation and proprietary income. Employee compensation, in turn, consists of wage and salary payments as well as benefits (health, retirement, etc.) and employer paid payroll taxes (employer side of social security, unemployment taxes, etc.). Proprietary income consists of payments received by self-employed individuals and unincorporated business owners.

- **Value Added:** The combined value-added impact of rail-related activity amounted to nearly $2.6 billion and represented about 1.3 percent of the state's GSP.

- **Output:** In terms of total revenue, the rail-related industries generated about $5.7 billion in output.

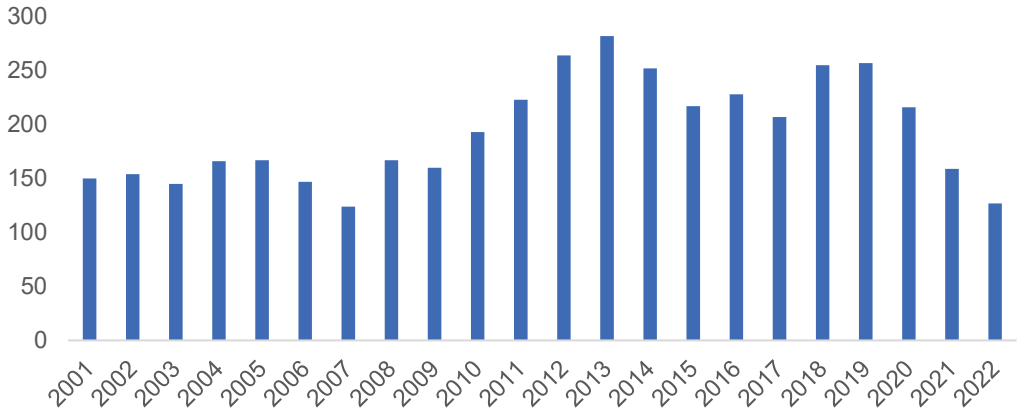
Note: The following pertains to Oklahoma's railroads collectively; the employment totals provided are not exclusive to short line railroads.

As shown in the following figure, total employment in the rail transportation support activities industry was relatively stagnant in the years prior to the establishment of the tax credit, averaging approximately 150 employees between 2001 and 2006.[14] Industry employment has varied in the years following the implementation of the incentive, growing to 282 by 2013 (nearly double the 2006 level) before subsequent years of decline brought total industry employment to 207 in 2017. By 2019, the total had increased by 50 jobs; the years since then have seen declines, though the COVID-19 pandemic has likely played a role in shaping these trends. Over the full time period shown, employment levels were essentially flat, decreasing by a compound annual growth rate (CAGR) of -0.8 percent.

[13] ODOT, "Oklahoma State Rail Plan," (2021). Accessed electronically at https://oklahoma.gov/content/dam/ok/en/odot/publications/SRP%202021%20Final%20with%20FRA%20Approval.pdf

[14] North American Industry Classification System (NAICS) code 488210, Support Activities for Rail Transportation, comprises establishments primarily engaged in providing specialized services for railroad transportation including servicing, routine repairing and maintaining rail cars, loading and unloading rail cars and operating independent terminals.

Figure 3: Oklahoma Rail Transportation Support Activities Industry Employment, 2001-2022

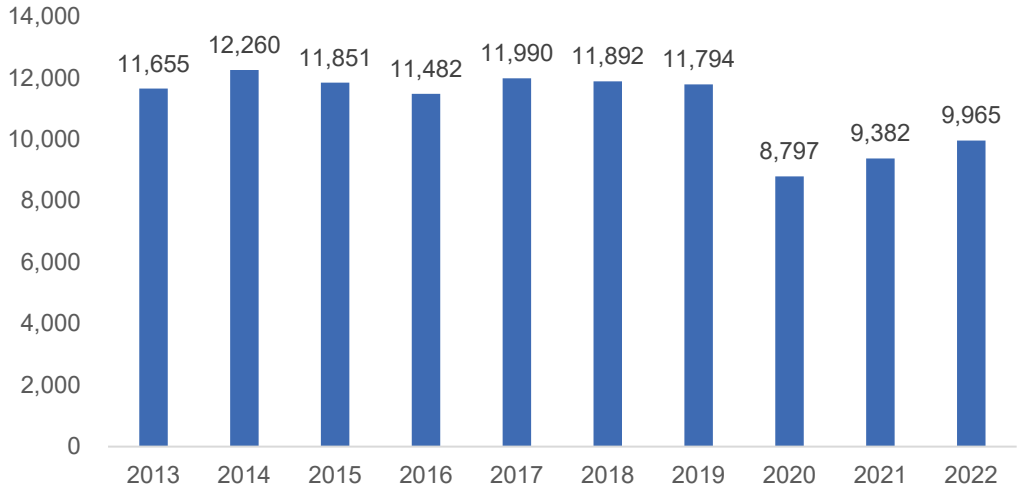


Source: U.S. Bureau of Labor Statistics Quarterly Census of Employment and Wages
Notes: NAICS code 488210, Support Activities for Rail Transportation. 2022 figures are preliminary.

Rail Infrastructure Condition and Capacity

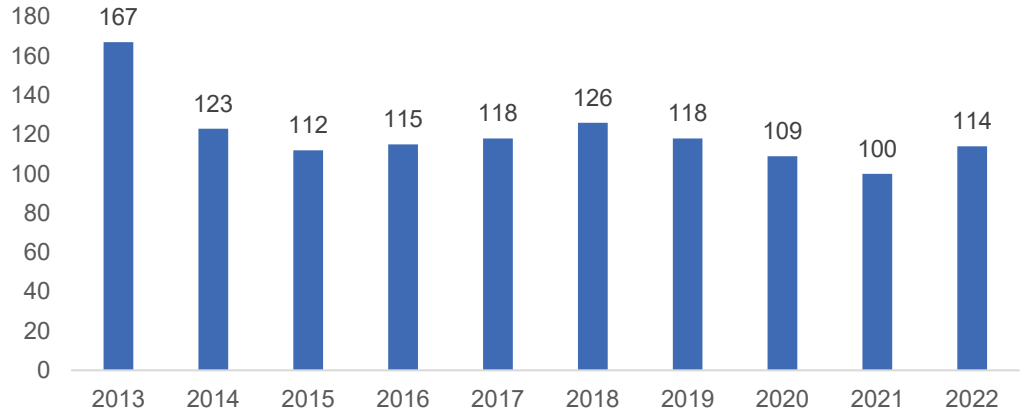
Over the past decade, statistics show that train accidents/incidents have generally declined, both nationally and in Oklahoma. As shown in the following figures, there were nearly 11,700 events across the U.S. in 2013 and just under 10,000 in 2022, equal to a CAGR of -1.7 percent. Oklahoma experienced a steeper decline over the same time period: there were 167 accidents/incidents in 2013 and 114 in 2023 – a CAGR of -5.6 percent. It is likely that the impacts of the COVID-19 pandemic on rail activity contributed to the number of accidents/incidents in 2020-2022. For the period of 2013-2019, the number of accidents/incidents nationally was effectively flat (a CAGR of 0.2 percent); Oklahoma experienced a more significant decline, with a CAGR of -5.6 percent.

Figure 4: Total Accidents/Incidents, U.S. (2013-2022)



Source: FRA Office of Safety Analysis

Figure 5: Total Accidents/Incidents, Oklahoma (2013-2022)



Source: FRA Office of Safety Analysis

Despite these trends, several recent derailments across the U.S. have highlighted the costly and potentially long-lasting effects of aging and/or unreliable rail infrastructure. For example, Norfolk Southern has estimated that the East Palestine, Ohio derailment in February 2023 caused more than $800 million in damage, not including the cost of compensating the East Palestine community or mitigating environmental impacts, which are likely significant).[15]

Given the important role of the industry to Oklahoma's economy, it is important for the rail network to operate consistently and safely. At the same time, however, freight rail is a notoriously capital-intensive industry. Most short line railroads operate on legacy infrastructure suited only for low-density operations and lighter weight railcars (263,000 pounds or less). This infrastructure must be upgraded to handle today's heavier, industry standard 286,000-pound railcars.

Unlike roadways, the private owners of U.S. freight railroads are responsible for their own maintenance and improvement projects. Freight railroads determine their project priorities under two categories: mission-critical projects and potentially funded/optional projects. Mission-critical projects include scheduled maintenance and unscheduled repairs. Potentially funded or optional projects include those that reduce bottlenecking, line extensions, information technology solutions, and related capital investments.

Compared with other major modes of transportation, railroad owners invest one of the highest percentages of revenues (19 percent) to maintain and add capacity to their system, spending nearly $25 billion annually.[16] From 1980 to 2022, America's freight railroads privately spent approximately $780 billion on capital expenditures and maintenance expenses related to locomotives, freight cars, tracks, bridges, tunnels, technology and other infrastructure and equipment.

As described in ODOT's 2021 Oklahoma State Rail Plan, state-sponsored rail investment in Oklahoma has been delivered through several programs, with funds for each provided by the Railroad Maintenance Revolving Fund (RMRF). Funding sources for the RMRF include an annual 4 percent tax on freight car revenues, lease agreements with short line rail operators on state-owned trackage, and right-of-way sales. Major state-sponsored rail investment programs include the ODOT Rail Safety Program, Rail Crossings

[15] CBS News, "Ohio Train Derailment Costs Double to $803 Million, Norfolk Southern Says," (July 27, 2023). Accessed electronically at https://www.cbsnews.com/news/ohio-train-derailment-norfolk-southern-east-palestine-cleanup-lawsuit-costs/
[16] AAR, "Railroad 101," (last updated June 2023). Accessed electronically at https://www.aar.org/wp-content/uploads/2020/08/AAR-Railroad-101-Freight-Railroads-Fact-Sheet.pdf

Safety Initiative, and ODOT Construction Work Plan. The state's rail system also receives federal rail-related funding.[17]

Freight rail needs and opportunities identified in the State Rail Plan include (but are not limited to) Class I rail corridor development, updates to accommodate heavier railcars, enhanced railroad access, and reduction of bottlenecks.

Other external analyses confirm that investments in Oklahoma's freight rail network are needed. While now dated, in its 2013 Report Card for Oklahoma's Infrastructure report, the ASCE gave the state's rail system a 'B' based on its infrastructure needs, capability and funding (the nation as a whole received a 'C+' for rail infrastructure in that year).[18] The evaluation found that segments of the short line network could not accommodate the high-capacity freight cars common to Class I railroads, and while the short line industry generally had the resources to maintain basic operations, increasingly higher funding would be required to maintain operations in accordance with escalating industry standards.[19]

[17] ODOT, "Oklahoma State Rail Plan," (September 15, 2021). Accessed electronically at https://oklahoma.gov/content/dam/ok/en/odot/publications/SRP%202021%20Final%20with%20FRA%20Approval.pdf
[18] 2013 is the most recent year for which Oklahoma data is available.
[19] American Society of Civil Engineers – 2013 Report Card for Oklahoma's Infrastructure. Accessed electronically at https://www.infrastructurereportcard.org/wp-content/uploads/2016/10/ASCE-OK-2013-Report-Card.pdf

Incentive Usage & Administration

Incentive Characteristics

Available since 2006, Oklahoma's Railroad Modernization Tax Credit is equal to 50 percent of qualified railroad reconstruction or replacement expenditures incurred by a Class II or Class III railroad.[20] Qualified expenditures include (a) track maintenance, natural disasters, and reconstruction or replacement of railroad infrastructure including track, roadbed, crossings, bridges, industrial leads, and track-related structures; or (b) new construction of industrial leads, switches, spurs, and sidings, and extensions of existing sidings.[21]

For tax years 2020 through 2029, the amount of the credit is limited to $5,000 per mile of railroad track owned or leased within the State by the taxpayer. Unused credits can be carried forward or transferred for five years following the year of qualification.

The total amount of credits used to offset tax liability is limited to $2 million for tax years (TYs) 2018 and 2019, and $5 million for TY 2020 and all subsequent tax years. In the event that such credits exceed the applicable annual limit in a given year, all claims used to offset tax liability are reduced by a percentage calculated by the OTC. This tax credit is currently scheduled to sunset on January 1, 2030.

As currently structured, this program aligns with several applicable incentive design best practices.[22] The tax credit is targeted to the industry, leverages private capital, sets an aggregate dollar cap, and has built-in accountability via the administrative process (as discussed in this chapter). However, the funds provided under the program are not front-loaded, and there are no specific, regular reporting requirements associated with the credits issued,

Historic Use of the Incentive

The following table summarizes historic use of the credit for the period of TY 2017-2021. Over the timeframe, an average of 10 returns per year reduced overall tax liability among claimants by an average of approximately $2.4 million. On a per-return basis, this equates to an average of just over $270,000. Generally, the average reduction is declining over the time period in question.

Table 5: Tax Credit Activity, TY 2017-2021 ($ in Millions) *

	Total Returns	Carry Forward**	Credit Established During TY	Total Amount Claimed	Used to Reduce Tax Liability	Avg. Claim per Return	Avg. Reduction in Liability
2017	15	$2.0	$1.4	$3.3	$1.3	$220,569	$88,009
2018	8	$0.5	$2.3	$2.8	$2.5	$343,925	$308,673
2019	12	$1.9	$1.9	$3.7	$2.4	$310,955	$202,211
2020	7	$0.0	$3.3	$3.3	$3.1	$465,851	$439,040
2021	9	$0.0	$2.9	$2.9	$2.9	$325,252	$320,273
Avg.	**10.2**	**$0.9**	**$2.3**	**$3.2**	**$2.4**	**$333,310**	**$271,641**

Source: Oklahoma Tax Commission
** Average Claim per Reward and Average Liability Reduction totals are real values, not in $ millions.*
*** Carry forward represents unused credit carried over from prior year(s).*

[20] 68 O.S. § 2357.104
[21] Oklahoma Legislature, "Enrolled Senate Bill No. 1322." Accessed electronically at http://webserver1.lsb.state.ok.us/cf_pdf/2019-20%20ENR/SB/SB1322%20ENR.PDF. As discussed in the Introduction & Project Background chapter, SB 1322 of 2020 made a number of statutory changes to this program, including extending the sunset date to January 1, 2025, eliminating the 25 percent reduction in calculated credit amount (which was in place for TYs 2016-2019), increased the per mile credit from $2,000 to $5,000 for TYs 2020 and beyond, increased the annual cap from $2 million to $5 million for TYs 2020 and beyond, and added track maintenance, natural disasters, and crossings to the list of qualified expenditures. In addition to these substantive changes, SB 1322 also made minor modifications to the program statute, including deleting obsolete language and eliminating specified taxpayer elections and related prohibitions.
[22] A discussion of business incentives best practices is included in Appendix E.

Notably, the totals above reflect the impacts of some of the statutory changes cited in the preceding section (though isolating and accurately allocating the impacts of those changes is difficult, if not impossible). For example, the per-mile credit was $2,000 for TY 2017-2019, and $5,000 for TY 2020 and beyond. In addition, for TY 2017-2019, the credit was limited to 75 percent of the otherwise allowable credit. Further, the aggregate annual cap was limited to $2 million in TYs 2018 and 2019, and $5 million for TY 2020 and after. It is not clear why the preceding table includes years for which the aggregate credits used to reduce tax liability exceeded the stated thresholds.

Other, external factors may contribute to overall program activity, including inflationary concerns, economic uncertainty, rising construction costs, global supply chain issues, and more.

A limited number of beneficiaries comprise the vast majority of claims made. As shown in the following table, five taxpayers are responsible for more than $14.1 million (92.2 percent) of the $15.3 million in claims made between fiscal years (FY) 2017 and 2021. Of these claimants, only Farmrail System, Inc. is in the railroad industry.[23] Halliburton is the single largest beneficiary of the program, with claims totaling more than $5.4 million over the period.

Table 6: Aggregate Claims by Taxpayer, FY 2017-2021 ($ in Millions) *

Beneficiary	Total Claims	% of Total Claims
Halliburton *(Energy)*	$5.5	35.6%
Atwood Family	$3.7	24.2%
Wal-Mart Stores *(Retail)*	$3.0	19.8%
Green Family	$1.1	7.0%
Farmrail System, Inc. *(Rail)*	$0.9	5.6%
Subtotal	**$14.1**	**92.2%**
All Others	$1.2	7.8%
Total	**$15.3**	**100.0%**

Source: Oklahoma Office of Management and Enterprise Services
** Reported on a fiscal year basis (as opposed to tax year).*

Strategic Industrial Development Enhancement (SIDE) Act

A new state program provides additional financial support for short line railroads in Oklahoma. The SIDE Act was signed into law in 2022 to promote the competitiveness of rural industrial parks by improving connections between railroads and industrial park developments. SIDE Act improvements can be done through projects that include qualified economic development expenditures in industrial parks, qualified initial infrastructure expenditures associated with industrial parks, or a combination of the two. The program provides a 50 percent tax credit for the development of new rail infrastructure to serve new and expanding businesses located adjacent to Class II/III railroads in rural Oklahoma.[24]

Incentive Administration

The OTC and ODOT are jointly responsible for administering the program. Overall, its administration is relatively straightforward and consists primarily of verifying project eligibility, processing tax credit claims, and reporting. Administrative responsibilities are summarized in the following:

[23] Farmrail System, Inc. is an employee-owned holding company for two Class III common-carrier railroads.
[24] Oklahoma Department of Commerce, "SIDE Act – Incentives to Industrial Parks Located in Rural Areas of Oklahoma." Accessed electronically at https://www.okcommerce.gov/doing-business/business-relocation-expansion/incentives/side-act/

1. **Determining Project Eligibility:** In order to be eligible for the credit, a project's qualified railroad replacement or reconstruction expenditures must first be verified and approved by ODOT. To get this approval, taxpayers complete and submit ODOT's State Rail Project Application to the Rail Programs Division. The Division reviews the application for compliance with the program requirements and criteria summarized in the following table:

Table 7: Project Requirements and Criteria

Project Type	Requirement(s) and Criteria
Cross Tie	For a ratio equivalent to a minimum of 500 ties per track mile. Qualified expenditures for a cross tie project include (but are not limited to) items such as engineering costs, materials, labor, equipment, and freight.
Bridge	Improvements that qualify the bridge for a minimum 286,000-pound rating. Applications must also include a Professional Engineers report which has been stamped to validate the structural integrity of the improvement to be made. Qualified expenditures for a bridge project include (but are not limited to) items such as engineering costs, bridge materials, labor, equipment, and freight.
Bridge with Culvert	Replacement of a bridge structure with a culvert will require plans certified by a Professional Engineer. The plans are filed with the application identifying the specifications that must be met to accommodate a 286,000-pound rating and that proper hydraulic specifications have been maintained.
Rail Replacement	For a main line track, must have a minimum rail weight of 110 pounds per foot and new ties. All replacement rail must be classified as New Rail, Number 1 Rail or Number 2 Rail relay rail. A siding or industrial lead project may use Number 1 relay ties.
Track Maintenance	Expenditures incurred by the railroad in the normal course of day-to-day operations of the railroad. Qualified expenditures include inspections, tie and rail replacement not otherwise covered, bridges, mowing, spraying, and all other material, labor, equipment, and freight required to keep the railroad operational.
Crossings	Expenditures incurred by the railroad at the intersection of any railroad to roadway, public or private. Qualified expenditures include (but are not limited to) items such as engineering costs, materials, labor, equipment, and freight.
Natural Disasters	Expenditures incurred by the railroad because of the natural disaster. Qualified projects shall have been caused by floods, fire, tornados, earthquakes or other acts of God or when a local, state or national emergency declaration is made in the area the railroad operates in. Qualified expenditures include (but are not limited to) items such as engineering costs, material, labor, equipment, and freight.

Source: ODOT – State Rail Project Application

2. **Claiming Credits:** ODOT provides a certificate of verification upon completion of an eligible project; this certificate of verification must be provided to the OTC as proof of eligibility in order to claim the credit.

   Eligible taxpayers claim the credits on their corporate income tax returns. They also must populate and submit Form 511CR (Other Credits), identifying unused credit carried over from prior years; credit established during the current tax year; and total available credit (equal to the sum of the two).

   As referenced previously, the total amount of credits authorized to offset tax is adjusted annually to limit the amount of credits used to offset tax liability (that limit is $5 million for TY 2020 and beyond). The OTC annually calculates and publishes a percentage by which the credits authorized are

reduced, so that the total amount of credits used to offset tax does not exceed the applicable annual limit.

3. **Reporting:** When the tax year is complete and timely returns have been filed and processed, the OTC is the source for data associated with the use of the tax credit. Estimated tax expenditures – along with the number of returns related to this and other tax preferences – are published in the OTC's biennial tax expenditures reports.

   As noted previously, unused credits are transferrable for a period of five years, and there are reporting requirements associated with transfers. The person originally allowed the credit, and the subsequent transferee, must jointly file a copy of the written transfer agreement (Form 569 – Transfer or Allocation of a Tax Credit) with the OTC within 30 days of the transfer.[25] The written agreement contains the name, address, and taxpayer identification number of the parties to the transfer; the amount of credit being transferred; the year the credit was originally allowed to the transferring person; and the tax year(s) for which the credit may be claimed.

   Taxpayers are required to report to the OTC, on an annual basis, the amount of and statutory basis for each credit that may be transferred or allocation. If the credit is transferrable, the report includes whether the credit will or may be transferred, and the name of the taxpayer to whom the credit is transferred. The report also includes whether the credit will or may be allocated by a pass-through entity and the identity of the transferee. If a taxpayer fails to file the report as required, the OTC will disallow the tax credit; however, upon filing of the report, the credit will be allowed.[26]

There are a number of challenges associated with the administration of this program, summarized below:

- **Transferability:** Critics of transferrable tax credits question whether it is prudent for tax breaks to be sold to companies in industries the tax credits were never meant to incent. Additionally, selling the credits generally deflates their value, as they are typically sold by those companies at 85 to 90 cents on the dollar.

- **Data Availability:** A general lack of high-quality data makes it difficult for the State to accurately report on the impact of the incentive.

- **Reporting Consistency:** The data OMES publishes on the State's data and statistics website, while useful, is difficult to summarize and analyze because there is no consistent identifier for unique taxpayers. To analyze credits claimed by taxpayers, one must use the taxpayer's name, which may or may not be consistent. For example, Wal-Mart made three claims associated with this credit between FY2017 and FY2021; the records use two variations of the business name: "WAL-MART STORES INC" and WAL-MART STORES EAST, LP." Data must be cleaned and streamlined carefully and thoroughly before it can be used. This manual manipulation of the data increases the possibility of human error.

[25] Oklahoma Tax Commission, "Form 569 – Transfer or Allocation of a Tax Credit." Accessed electronically at https://www.ok.gov/oktax/taxcredit/app/content.php?display=TaxCreditFormPage
[26] 68 O.S. § 2357.1A-1 (HB 1284, First Regular Session of the 53rd Legislature [2011])

Economic & Fiscal Impact

Economic & Fiscal Impact Approach

The project team's economic impact analysis is based on a review of data provided by the OTC for returns claiming the credit in tax years 2017-2021 (the time period discussed in the preceding chapter). The economic impacts associated with the investments were estimated using IMPLAN economic impact software. The methodology for using the IMPLAN model is provided in Appendix C.

To evaluate the impacts of the railroad modernization tax credit, the project team examined the credits established annually between tax years 2017 and 2021. For purposes of calculating the economic and tax impact, this amount was doubled, as the credit is equal to 50 percent of qualified track improvement expenditures. Because the cap on the program limits credits earned to $5,000 per mile of railroad track owned or leased in Oklahoma, it is possible that total track improvement expenditures are more than double the total credits established; however, this approach serves as a reasonable proxy. The annual economic impact of associated activity was calculated using IMPLAN Sector 64 – Maintenance and Repair Construction of Highways, Streets, Bridges, and Tunnels.

Estimated Impacts

Between 2017 and 2021, an aggregate total of approximately $11.7 million in credits was established, compared to just over $1.0 million in State tax revenue generated. Because the economic impact of construction is finite (versus a business that is assumed to operate for the foreseeable future), the tax impact of this program is negative.

It should be noted, however, that a traditional economic impact analysis does not capture the full benefits if the qualified expenditures. For example, improved transportation infrastructure can reduce travel time and costs. For goods transiting the state these benefits are allocated outside of Oklahoma. Railroad transportation reduces the number of trucks on the highway, which can slow road deterioration and reduce traffic bottlenecks and other delays. Rail transportation is environmentally more beneficial than truck transport as fewer greenhouse gasses are released per ton of goods moved by rail than by truck. In addition, new rail capacity may attract a new firm to the region resulting in new permanent employment. However, the information currently collected by the State does not allow for this type of analysis.

In 2019, a similar economic impact analysis was performed on the State of Alabama's then-proposed Tax Credit for Qualified Railroad Track Maintenance Expenditures. This study found that the average cost of track replacement/repair is approximately $385,000 per mile.[27] A 2015 study by the Washington State Department of Transportation found that the cost rehabilitation estimate for rail replacement was $80 per track foot, equal to $422,400 per mile. Given these values, it is reasonable to assume that more than $23.3 million (double the credit value of $6 million) was spent in Oklahoma on railroad track replacement and maintenance projects.

[27] StrategyWise – Economic Impact Analysis: Tax Credit for Qualified Railroad Track Maintenance Expenditures (February 15, 2019).

Table 8: Estimated Impact of Railroad Tax Credits

		Output	Value Added	Labor Income	Employment	Estimated Oklahoma Tax Revenue
2017	Direct Effect	$2,700,202	$903,446	$716,160	14	$23,779
	Indirect Effect	$1,943,212	$959,095	$691,913	10	$60,490
	Induced Effect	$1,030,196	$556,562	$309,625	8	$28,382
	Total Effect	**$5,673,609**	**$2,419,103**	**$1,717,698**	**32**	**$112,651**
2018	Direct Effect	$4,670,110	$1,562,547	$1,238,628	24	$41,315
	Indirect Effect	$3,364,617	$1,658,007	$1,197,388	18	$105,099
	Induced Effect	$1,771,428	$957,240	$532,332	13	$49,313
	Total Effect	**$9,806,155**	**$4,177,793**	**$2,968,348**	**55**	**$195,727**
2019	Direct Effect	$3,908,887	$1,307,854	$1,036,733	20	$34,343
	Indirect Effect	$2,819,866	$1,387,343	$1,002,924	14	$87,364
	Induced Effect	$1,474,168	$796,789	$442,935	11	$40,992
	Total Effect	**$8,202,922**	**$3,491,985**	**$2,482,593**	**45**	**$162,699**
2020	Direct Effect	$6,908,212	$2,311,381	$1,832,228	34	$60,278
	Indirect Effect	$4,991,033	$2,451,583	$1,773,957	25	$153,340
	Induced Effect	$2,590,491	$1,400,466	$778,218	18	$71,948
	Total Effect	**$14,489,736**	**$6,163,430**	**$4,384,403**	**78**	**$285,566**
2021	Direct Effect	$6,255,520	$2,093,001	$1,659,118	30	$54,208
	Indirect Effect	$4,527,117	$2,220,113	$1,607,900	22	$137,899
	Induced Effect	$2,332,532	$1,261,268	$700,590	16	$64,703
	Total Effect	**$13,115,169**	**$5,574,382**	**$3,967,608**	**69**	**$256,810**

Source: PFM IMPLAN analysis output, September 2023

Table 9: Annual Tax Revenue Generated

	Credit Established During TY	Estimated Oklahoma Tax Revenue	Net Impact
2017	$1,350,101	$112,651	($1,237,450)
2018	$2,289,957	$195,727	($2,094,230)
2019	$1,879,679	$162,699	($1,716,980)
2020	$3,257,815	$285,566	($2,972,249)
2021	$2,893,040	$256,810	($2,636,230)
Total	**$11,670,592**	**$1,013,454**	**($10,657,138)**

Source: PFM IMPLAN analysis output, September 2023

Incentive Benchmarking

Benchmarking Introduction

For evaluation purposes, benchmarking provides information related to how peer states use and evaluate similar incentives. At the outset, it should be understood that no states are 'perfect peers' – there will be multiple differences in economic, demographic and political factors that will have to be considered in any analysis; likewise, it is exceedingly rare that any two state incentive programs will be exactly the same.[28] These benchmarking realities must be taken into consideration when making comparisons – and, for the sake of brevity, the report will not continually re-make this point throughout the discussion.

The process of creating a comparison group for incentive benchmarking typically begins with bordering states because proximity often leads states to compete for the same regional businesses or business/industry investments. Additionally, neighboring states often (but not always) have similar economic, demographic, or political structures that lend themselves to comparison. Given the national footprint of Class II and III railroads, it is beneficial to broaden the benchmarking research to encompass states beyond those sharing a border with Oklahoma.

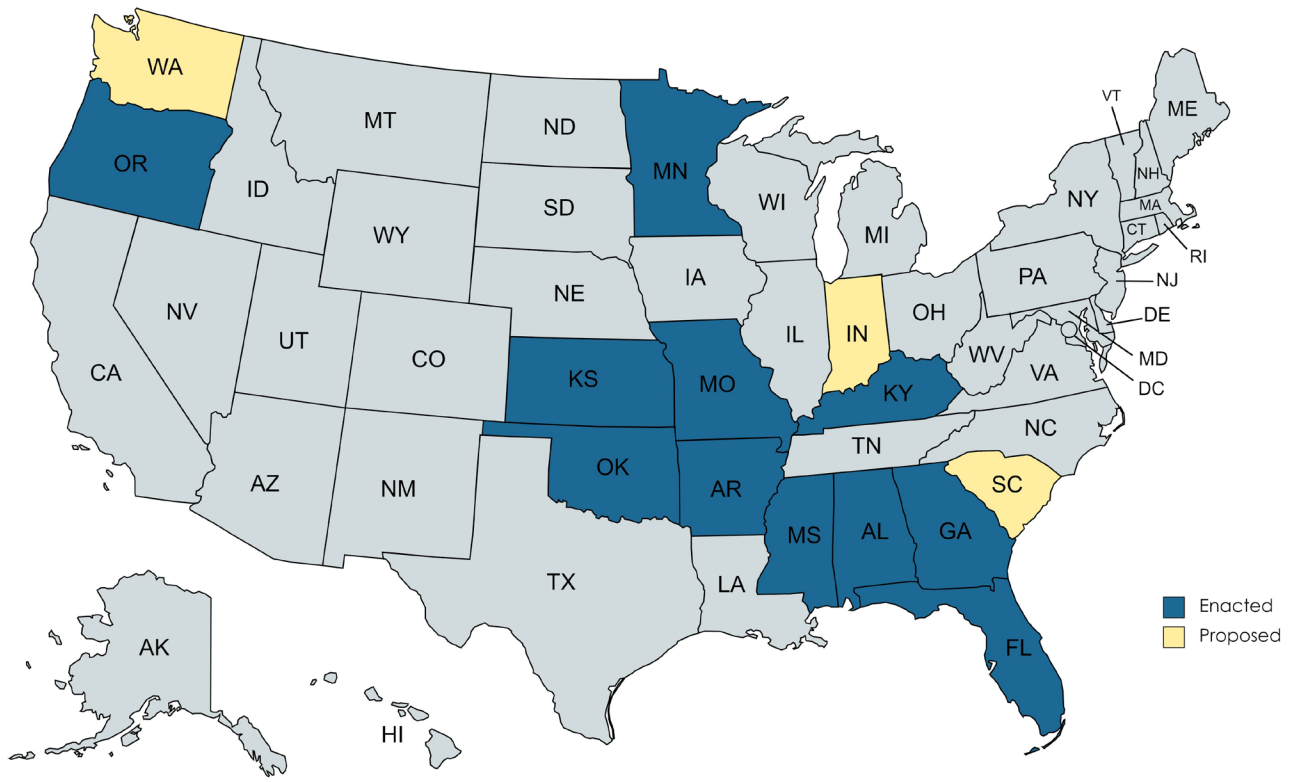
The following provides a brief discussion of the key considerations stemming from this analysis. A detailed description of comparable incentive programs is provided in **Appendix D.**

Rail Industry Tax Credits

As shown in the following map, ten states were found to have active programs comparable to Oklahoma's: Alabama, Arkansas, Florida, Georgia, Kansas, Kentucky, Minnesota, Mississippi, Missouri, and Oregon. In addition, several other states have attempted to enact similar tax credits in recent years or are currently considering them, including Indiana, South Carolina, and Washington. The federal government also offers a similar program, the 45G tax credit. While this tax credit, along with numerous others, would often be allowed to expire and have to be temporarily extended by Congress, with the passage of the Consolidated Appropriations Act of 2021, the federal short line railroad tax credit has been made permanent.

[28] The primary instances of exactly alike state incentive programs occur when states choose to 'piggyback' onto federal programs.

Figure 6: States with Active or Proposed Incentives



In comparing the basic provisions of enacted programs, some state incentives – including Oklahoma's – are relatively generous, capping the program at $5,000 multiplied by track miles. Others have caps as low as $1,000 per mile, and the average across all benchmark states is $4,000. Other comparable programs are capped at $3,500 multiplied by track miles (in alignment with the federal credit), and Alabama increased its cap to $4,100 per tack mile for calendar years 2023-2027. Other notable nuances in program provisions exist, including:

- **Robustness:** In addition to the credit Kentucky offers to railroad companies for infrastructure improvements, it also provides a 25 percent railroad expansion tax credit to rail facilities who own fossil energy or biomass resources or railway companies that service those businesses; the credit is provided for railroad expansion or upgrades to accommodate the transportation of those resources.

  Kentucky also allows for an economic development tax credit of up to 100 percent for the construction and installation of railroad spurs to connect economic development projects to existing railroads. The credit is available to businesses engaged in manufacturing, agribusiness, non-retail service, technology or national or regional headquarters operations.

- **Administrative Cost Recovery:** Alabama imposes a fee equal to one percent of qualified expenditures, up to $10,000, for processing the taxpayer's application for a credit.

- **Transfer Limitations:** Alabama requires that credits be transferred at a value of at least 85 percent of the present value of the credit, and credits can be transferred only once. The State also collects a transfer fee of $1,000 per transferee.

Other Tax-Based Incentives

In addition to the tax credits discussed in the preceding section, several states provide other tax-based incentives for railroad infrastructure improvements, including exemptions, special tax treatment, and other relief mechanisms. While some of these tax preferences do not directly support the funding of railroad infrastructure improvements, they do "free up" financial resources through reduced tax burden. Examples include:[29]

- **Exemptions:** Massachusetts and New Jersey, for the most part, exempt railroads from property tax, and New York allows an exemption from income and franchise tax for railroad redevelopment corporations. Kansas provides a property tax exemption for all railroad machinery and equipment that is acquired, leased, or transported into the state.

  In addition, almost all states offer some form of railroad common carrier exemption. Rolling stock is the most common item exempted, and a majority cover parts for maintenance and repair. Thirty-four states have broader exemptions that cover purchases of rolling stock by other industries, such as manufacturers and utilities. Oklahoma's railroad common carrier exemption applies to rail spikes manufactured in-state; track materials and structures are not covered. Its railroad rolling stock exemption is limited to rail transportation used to haul coal to Oklahoma coal-fired electricity plants.[30]

- **Special Tax Treatment:** Connecticut, North Carolina, and Pennsylvania impose statewide gross earnings or receipt taxes on railroads (rather than property taxes).

- **Other Relief Mechanisms:** New York and Virginia provide railroads property tax relief by using an individual classification rule, which inventories each item of taxable property and values it separately regardless of the cooperative effect it may have on the railroad's other properties. New York provides additional relief by combining the individual classification rule with an established railroad property value ceiling that is adjusted upward based on railroad profitability.

Grant and/or Loan Programs

State grant and loan programs provide support for railroad maintenance, construction, and rehabilitation, with some allowing for purchase and/or preservation for future use. Benefits may include lower interest rates, longer loan terms and, in some instances, the opportunity to combine grants with matching funds as a loan down payment. Funds are typically competitively awarded, and many states require applications to quantify the benefits stemming from potential projects for which funding is requested, including job creation, environmental improvements, and truck diversion. Examples of state grant and loan programs targeted to short line railroads include (but are not limited to):

- **Idaho:** The Rural Economic Development and Integrated Freight Transportation revolving loan program assists businesses and qualified short line rail or intermodal freight shippers with loans for upgrading, expanding, rehabilitating, purchasing, or modernizing equipment for the Idaho freight shipping community. There is a $100,000 funding cap on individual projects.

- **Oregon:** The Short Line Credit Risk Premium Account provides grants that can cover up to 100 percent of the Credit Risk Premium set forth in the granting of a federal RRIF loan. In determining which projects receive funds, the Oregon State DOT considers the amount of funds available and the

[29] Discussion is taken primarily from Federal Railroad Administration – Summary of Class II and Class III Railroad Capital Needs and Funding Sources: A Report to Congress (October 2014).
[30] Virginia Joint Legislative Audit and Review Commission, "Trade and Transportation Incentives," (June 7, 2021). Accessed electronically at https://jlarc.virginia.gov/pdfs/reports/Rpt550.pdf

demonstrable public benefits of the project, including enhanced safety, air quality, rural development, and reduced demand for the expansion of highway capacity (among other factors).

- **North Carolina:** The Short Line Railroad Improvement program supports short line rail infrastructure health and performance throughout the state by providing matching grants to short line rail companies. Grants do not exceed 50 percent of the non-federal share and must be matched by equal or greater funding from the applicant. Total grants do not exceed $5 million per fiscal year.

- **Tennessee:** The State's Short Line Railroad Preservation Grants preserve rail service to local communities and expand rail connectivity to sites along existing rail corridors. The focus of the program is on facilitating the efficient and economical movement of freight within Tennessee by strengthening the network of short line railroads in the state. Projects have a 90/10 funding split (90 percent State funds/10 percent local funds).

- **Federal:** The Railroad Rehabilitation and Improvement Financing program provides loan opportunities to improve or rehabilitate intermodal facilities and rail equipment. Initially, the program's ceiling was set at $3.5 billion, with $1.0 billion directed toward non-Class I railroads. In 2005, the ceiling was increased to $35.0 billion, with $7.0 billion set aside for non-Class I railroads.

Benchmarking Program Evaluations

Several evaluations of similar programs exist that provide additional context related to the effectiveness of the various approaches to railroad infrastructure support. Evaluations of tax credit programs include the following examples:

- **Texas:** A 2016 study conducted by the Texas Department of Transportation sought to estimate the economic impact of the state's short line railroads. The analysis found that average short line railroad costs are less than average truck costs. Specifically:[31]

  - Shipping costs: 7.5 percent lower
  - Maintenance costs: 70.2 percent lower
  - Safety costs: 37.9 percent lower
  - Emission costs: 7.0 percent lower
  - Total transportation cost: 24.3 percent lower

  Moreover, the results of the economic impact analysis indicated that, at the state level, the operation of short line railroads in Texas contributes approximately 1,476 jobs, nearly $114 million in labor compensation, and more than $354 million in economic output.

  The research also found that short line railroads in Texas have substantial needs, in terms of infrastructure improvements – but these improvement needs are typically not affordable for short line operators.

[31] Texas Department of Transportation, "Transportation and Economic Impact of Texas Short Line Railroads," (September 2016). Accessed electronically at https://ftp.dot.state.tx.us/pub/txdot-info/tpp/short-line-impact.pdf

Appendices

Appendix A: 68 O.S. § 2357.104 – Tax Credit for Railroad Reconstruction or Replacement Expenditures (Effective until November 1, 2023)

A. Except as otherwise provided by this section, for taxable years beginning after December 31, 2005, and ending before January 1, 2025, there shall be allowed a credit against the tax imposed by Section 2355 of this title equal to fifty percent (50%) of an eligible taxpayer's qualified railroad reconstruction or replacement expenditures.

B. For tax years 2020 through 2024, the amount of the credit shall be limited to the product of Five Thousand Dollars ($5,000.00) and the number of miles of railroad track owned or leased within this state by the eligible taxpayer as of the close of the taxable year.

C. The credit allowed pursuant to subsection A of this section but not used shall be freely transferable, by written agreement, to subsequent transferees at any time during the five (5) years following the year of qualification. An eligible transferee shall be any taxpayer subject to the tax imposed by Section 2355 of this title. The person originally allowed the credit and the subsequent transferee shall jointly file a copy of the written credit transfer agreement with the Oklahoma Tax Commission within thirty (30) days of the transfer. The written agreement shall contain the name, address and taxpayer identification number of the parties to the transfer, the amount of credit being transferred, the year the credit was originally allowed to the transferring person and the tax year or years for which the credit may be claimed. The Tax Commission shall promulgate rules to permit verification of the timeliness of a tax credit claimed upon a tax return pursuant to this subsection but shall not promulgate any rules which unduly restrict or hinder the transfers of such tax credit. The Department of Transportation shall promulgate rules to permit verification of the eligibility of an eligible taxpayer's expenditures for the purpose of claiming the credit. The rules shall provide for the approval of qualified railroad reconstruction or replacement expenditures prior to commencement of a project and provide a certificate of verification upon completion of a project that uses qualified railroad reconstruction or replacement expenditures. The certificate of verification shall satisfy all requirements of the Tax Commission pertaining to the eligibility of the person claiming the credit.

D. Any credits allowed pursuant to the provisions of subsection A of this section but not used in any tax year may be carried over in order to each of the five (5) years following the year of qualification.

E. As used in this section:

1. "Class II and Class III railroad" means a railroad that is classified by the United States Surface Transportation Board as a Class II or Class III railroad;

2. "Eligible taxpayer" means any Class II or Class III railroad; and

3. "Qualified railroad reconstruction or replacement expenditures" means expenditures for:

a. track maintenance, natural disasters, and reconstruction or replacement of railroad infrastructure including track, roadbed, crossings, bridges, industrial leads and track-related structures owned or leased by a Class II or Class III railroad as of January 1, 2006, or

b. new construction of industrial leads, switches, spurs and sidings and extensions of existing sidings by a Class II or Class III railroad.

F. The total amount of credits authorized by this section used to offset tax shall be adjusted annually to limit the annual amount of credits to Two Million Dollars ($2,000,000.00) for tax years 2018 and 2019 and Five Million Dollars ($5,000,000.00) for tax year 2020 and all subsequent tax years. The Tax Commission shall annually calculate and publish a percentage by which the credits authorized by this section shall be reduced so the total amount of credits used to offset tax does not exceed the applicable annual limit. The formula to be used for the percentage adjustment shall be the applicable annual limit divided by the credits claimed in the second preceding year.

G. Pursuant to subsection F of this section, in the event the total tax credits authorized by this section exceed the annual applicable limit in any calendar year, the Tax Commission shall permit any excess over the annual applicable limit but shall factor such excess into the percentage adjustment formula for subsequent years.

Okla. Stat. tit. 68, § 2357.104
Current through Laws 2023EX1, c.52.

Amended by Laws 2020, c. 96, s. 1, eff. 11/1/2020.
Amended by Laws 2018, c. 7, s. 1, eff. 1/1/2018.
Amended by Laws 2016, c. 325, s. 1, eff. 1/1/2016.
Added by Laws 2005, SB 435, c. 413, § 8, emerg. Eff. 7/1/2005; Amended by Laws 2006, 2nd Extr. Sess., HB 1174, c. 44, § 24, eff. 7/1/2007; Amended by Laws 2008, SB 1799, c. 122, § 1, eff. 11/1/2008; Amended by Laws 2010, SB 1267, c. 327, § 24, emerg. Eff. 7/1/2010.

This section is set out more than once due to postponed, multiple, or conflicting amendments.

Appendix B: 68 O.S. § 2357.104 – Tax Credit for Railroad Reconstruction or Replacement Expenditures (Effective beginning November 1, 2023)

A. Except as otherwise provided by this section, for taxable years beginning after December 31, 2005, and ending before January 1, 2030, there shall be allowed a credit against the tax imposed by Section 2355 of this title equal to fifty percent (50%) of an eligible taxpayer's qualified railroad reconstruction or replacement expenditures.

B. For tax years 2020 through 2029, the amount of the credit shall be limited to the product of Five Thousand Dollars ($5,000.00) and the number of miles of railroad track owned or leased within this state by the eligible taxpayer as of the close of the taxable year.

C. The credit allowed pursuant to subsection A of this section but not used shall be freely transferable, by written agreement, to subsequent transferees at any time during the five (5) years following the year of qualification. An eligible transferee shall be any taxpayer subject to the tax imposed by Section 2355 of this title. The person originally allowed the credit and the subsequent transferee shall jointly file a copy of the written credit transfer agreement with the Oklahoma Tax Commission within thirty (30) days of the transfer. The written agreement shall contain the name, address and taxpayer identification number of the parties to the transfer, the amount of credit being transferred, the year the credit was originally allowed to the transferring person and the tax year or years for which the credit may be claimed. The Tax Commission shall promulgate rules to permit verification of the timeliness of a tax credit claimed upon a tax return pursuant to this subsection but shall not promulgate any rules which unduly restrict or hinder the transfers of such tax credit. The Department of Transportation shall promulgate rules to permit verification of the eligibility of an eligible taxpayer's expenditures for the purpose of claiming the credit. The rules shall provide for the approval of qualified railroad reconstruction or replacement expenditures prior to commencement of a project and provide a certificate of verification upon completion of a project that uses qualified railroad reconstruction or replacement expenditures. The certificate of verification shall satisfy all requirements of the Tax Commission pertaining to the eligibility of the person claiming the credit.

D. Any credits allowed pursuant to the provisions of subsection A of this section but not used in any tax year may be carried over in order to each of the five (5) years following the year of qualification.

E. As used in this section:

1. "Class II and Class III railroad" means a railroad that is classified by the United States Surface Transportation Board as a Class II or Class III railroad;**2.** "Eligible taxpayer" means any Class II or Class III railroad; and**3.** "Qualified railroad reconstruction or replacement expenditures" means expenditures for:

a. track maintenance, natural disasters, and reconstruction or replacement of railroad infrastructure including track, roadbed, crossings, bridges, industrial leads and track-related structures owned or leased by a Class II or Class III railroad as of January 1, 2006, or

b. new construction of industrial leads, switches, spurs and sidings and extensions of existing sidings by a Class II or Class III railroad.

F. The total amount of credits authorized by this section used to offset tax shall be adjusted annually to limit the annual amount of credits to Two Million Dollars ($2,000,000.00) for tax years 2018 and 2019 and Five Million Dollars ($5,000,000.00) for tax year 2020 and all subsequent tax years. The Tax Commission shall annually calculate and publish a percentage by which the credits authorized by this section shall be reduced so the total amount of credits used to offset tax does not exceed the applicable annual limit. The

formula to be used for the percentage adjustment shall be the applicable annual limit divided by the credits claimed in the second preceding year.

G. Pursuant to subsection F of this section, in the event the total tax credits authorized by this section exceed the annual applicable limit in any calendar year, the Tax Commission shall permit any excess over the annual applicable limit but shall factor such excess into the percentage adjustment formula for subsequent years.

Okla. Stat. tit. 68, § 2357.104
Current through Laws 2023EX1, c.52.

Amended by Laws 2023EX1, c. 33,s. 1, eff. 11/1/2023.
Amended by Laws 2020 , c. 96, s. 1, eff. 11/1/2020.
Amended by Laws 2018 , c. 7, s. 1, eff. 1/1/2018.
Amended by Laws 2016 , c. 325, s. 1, eff. 1/1/2016.
Added by Laws 2005 , SB 435, c. 413, § 8, emerg. Eff. 7/1/2005; Amended by Laws 2006, 2nd Extr. Sess., HB 1174, c. 44, § 24, eff. 7/1/2007; Amended by Laws 2008 , SB 1799, c. 122, § 1, eff. 11/1/2008; Amended by Laws 2010, SB 1267, c. 327, § 24, emerg. Eff. 7/1/2010.

This section is set out more than once due to postponed, multiple, or conflicting amendments.

Appendix C: IMPLAN Economic Impact Methodology

The economic impact software used to determine the multiplier effects is IMPLAN (**IM**pact Analysis for **PLAN**ning), a proprietary model; PFM has obtained a license for use of the IMPLAN model for these evaluations.

Overview

IMPLAN uses Social Accounting Matrices (SAMs) to capture the actual dollar amounts of all business transactions taking place in a regional economy, as reported each year by businesses and government agencies. SAM accounts are a better measure of economic flow than traditional input-output accounts, because they include "non-market" transactions. Examples of these transactions include taxes and unemployment benefits.

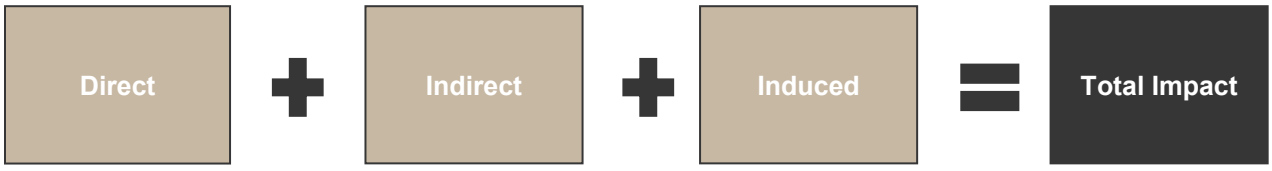
Multiplier Models

SAMs can be constructed to show the effects of a given change on the economy. These are called Multiplier Models. Multiplier Models study the impacts of a user-specified change in the chosen economy for 440 different industries. Because the Multiplier Models are built directly from the region-specific SAMs, they will reflect the region's unique structure and trade situation.

Multiplier Models are the framework for building impact analysis questions. Derived mathematically, these models estimate the magnitude and distribution of economic impacts, and measure three types of effects within the economy: direct, indirect, and induced.

- **Direct effects** are one or more production changes or expenditures made by producers/consumers as a result of an activity or policy.
- **Indirect effects** are the business-to-business purchases in the supply chain taking place in the region that stem from the initial industry input purchases. Typically, they are additional purchases to produce additional output.
- **Induced effects** are the changes in regional household spending patterns caused by changes in household income generated from the direct and indirect effects. The induced effects are generated by the spending of the employees within the business' supply chain.

Figure 7: The Flow of Economic Impacts



Each of these steps takes into consideration leakage from the economic study region spent on purchases outside of the defined area. Eventually, these leakages will stop the cycle.

Fiscal Impacts

The IMPLAN tax impact report identifies all tax revenue in the study area, across all levels of government that exist in that study area, for the specific industries and institutions affected by an event or group of events. Tax Impact results are based on the collected and reported taxes within the region for the given data year. IMPLAN taxes shown (and collected) are industry and geographically specific.

The IMPLAN tax impact report splits the tax impacts into the various tax categories based on the region's economy. There is no industry-specific profile for taxes paid by tax category, so the distribution across tax categories is an all-industry average. While this is a limitation of the IMPLAN fiscal reporting, the IMPLAN tax report serves as an appropriate measure of jurisdictional tax results in the aggregate. Tax results cannot be added to any summary or detailed results, as they are already included as a portion of Output. State taxes do not include taxes or district assessments levied by federal, county, sub-county, city, or township governments.

Taxes paid include payments from businesses and households. Personal income and employment taxes paid by the employer are included in the tax results and allocated according to the taxing jurisdiction. In detailed IMPLAN analyses, all payroll taxes typically paid at the place of employment are shown as household payments. Property tax and personal property tax reflects a combination of property and personal property taxes paid by both businesses and households.

Appendix D: Peer State Benchmarking

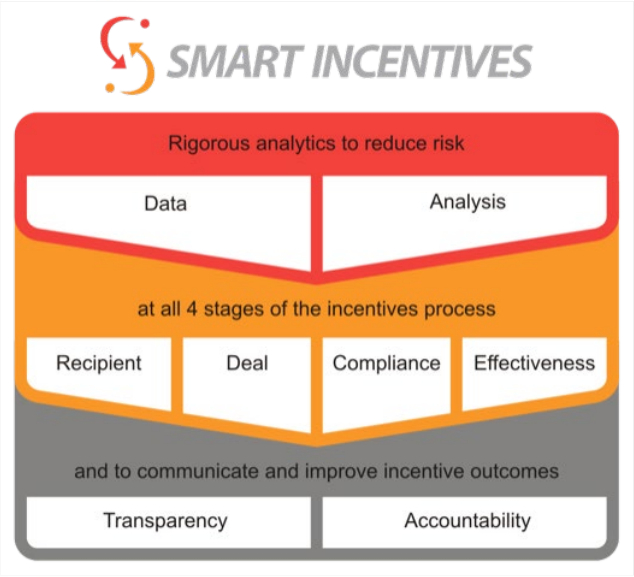
	Credit Name	Eligible Customers	Credit Amount Lesser of	Refundable	Carry Forward	Transferable	Annual Program Cap
Oklahoma	Credit for Railroad Modernization	Class II/III railroads	50% of eligible expenses or $5,000 x miles owned or leased	No	5 Years	Yes	$5 million
Alabama	Rail Credit	Class II/III railroads	50% of eligible expenses or $4,100 x miles owned or leased	Yes	None	Yes	$4.5 million annually 2023-2027, aggregate cap of $22.5 million
Arkansas	Railroad Modernization Tax Credit	Class II/III railroads	50% of eligible expenses or $5,000 x miles owned or leased	No	5 Years	Yes	None
Florida	Railroad Reconstruction & Replacement Expenditures Credit	Class II/III railroads	50% of eligible expenses or $3,500 x miles owned or leased	No	5 Years	Yes	None
Georgia	Railroad Track Maintenance Tax Credit	Class III railroads	50% of eligible expenses or $3,500 x miles owned or leased	No	None	Yes	None
Kansas	Short Line Railroad Tax Credit	Class II/III railroads; businesses served by class II/III railroads; businesses storing railcars on class II/III railroads	50% of eligible expenses or $3,500 x miles owned or leased	No	5 Years	Yes	$8.7 million
Kentucky	Railroad Maintenance and Improvement Tax Credit	Class II/III railroads	50% of eligible expenses or $3,500 x miles owned or leased	No	None	No	None
	Railroad Expansion Tax Credit	Class II/III railroads	25% of expenditures	No	None	No	$1 million
Minnesota	Short Line Railroad Infrastructure	Class II/III railroads	50% of eligible expenses or $3,000 x miles	No	5 Years	Yes	None

	Credit Name	Eligible Customers	Credit Amount Lesser of	Refundable	Carry Forward	Transferable	Annual Program Cap
	Modernization Credit		owned or leased				
Mississippi	Rail Infrastructure Tax Credit for Short Lines	Class II/III railroads	50% of eligible expenses or $5,000 x miles owned or leased	No	5 Years	Yes	$8 million
Missouri	Tax Credit for Qualified Railroad Infrastructure Improvements	Class II/III railroads	50% of eligible expenses or $5,000 x miles owned or leased	No	5 Years	Yes	$4.5 million
Oregon	Tax Credit for Short Line Railroad Rehabilitation	Class II/III railroads	Tier I: 50% of eligible expenses or $1,000 x miles owned or leased Tier II: 50% of eligible expenses or $3,500 x miles owned or leased	No	5 Years	Yes	$4 million per biennium

Appendix E: Business Incentives Best Practices

There has been extensive writing around what constitute business incentives best practices. From the project team's review of many sources,[32] it has identified 10 important best practices and sought to incorporate them into the analysis and discussion of this incentive.

As a starting point, business incentives should be viewed as a process, not an event. The award of an incentive and the incentive features are part of that process, and many of the identified best practices reflect that. The process itself should take into consideration each of these factors, which PFM's subcontractor, Smart Incentives, demonstrates in the following illustration:



While the project team believes this is a strong set of best practices, there may well be others that are as (or more applicable) in specific situations. It is also likely that some of the best practices will come into conflict in some situations. For example, application and reporting requirements may reduce the simplicity of business compliance. As a result, these will always be subject to analysis on a case-by-case basis.

The 10 best practices are:

1. **For maximum impact, incentives should be targeted.** Examples of useful targeting include companies or industries that export their goods or services out-of-state; high economic impact companies or industries – such as those with higher wages and benefits, significant job creation, or significant capital investment.

2. **Incentives should be discretionary.** In most instances, an application process enables the state government to require company disclosure of information related to eligibility criteria and enables

[32] Three resources in particular were relied upon on putting together the list of best practices. They are "What Factors Influence the Effectiveness of Business Incentives?" The Pew Charitable Trusts, April 4, 2019, accessed electronically at https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2019/04/what-factors-influence-the-effectiveness-of-business-incentives; "Improving Economic Development Incentives," Timothy J. Bartik, W.E. Upjohn Institute for Employment Research, 2018, accessed electronically at https://research.upjohn.org/cgi/viewcontent.cgi?article=1000&context=up_policybriefs; "Best Practices for the Design and Evaluation of State Tax Incentives Programs for Economic Development," Matthew N. Murray and Donald J. Bruce, January 2017, included within another evaluation at https://media.al.com/news_mobile_impact/other/AL%20ENTERTAIN%20NEWMKTS%203%209%2017.pdf

the state to reject applications that do not meet its standards.

3. **Incentives should leverage significant private capital.** Ideally, the incentive should leverage private investment that is at least several multiples of the state investment.

4. **Incentives should provide most of the benefit within 1-3 years and have a limited duration.** Company discount rates are much higher than for the state, and businesses will significantly devalue incentive payments in later years.

5. **Incentives should take into consideration state and/or local as well as industry economic conditions.** Incentives that are provided in high performing areas or for stable and profitable businesses or industries will likely fail the 'but for test' – meaning the activity would likely occur without the state incentive.

6. **'Smart' incentives help businesses overcome practical barriers to growth.** In particular, customized assistance for locally owned, small and medium-sized businesses can have significant impact.

7. **Incentives should be transparent.** The incentive purpose should be clearly articulated, as are eligibility requirements, and regular, detailed reporting should be required from all program recipients.

8. **Incentives should require accountability.** When upfront financial incentives are offered in return for job creation, retention, or capital investment, there should be contract language in place that allows the state to 'claw back' state resources should the company not meet performance requirements.

9. **Incentives should have caps.** To ensure the state's financial health, program dollar caps or limits should be in place. Incentive programs should also have a limited duration, with sunsets in place to require regular review of incentive performance.

10. **Incentives should be simple and understandable.** The state should be able to easily and effectively administer the incentive, and users should be able to readily comply with its requirements.