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

SPONSOR	Sens. Diamond Brantley, Hemphill and Cervantes/Reps. Montoya and Terrazas	**LAST UPDATED**	2/6/24
		ORIGINAL DATE	1/24/24
SHORT TITLE	Rail Infrastructure Tax Credit	**BILL NUMBER**	Senate Bill 28
		ANALYST	Graeser

REVENUE*
(dollars in thousands)

Type	FY24	FY25	FY26	FY27	FY28	Recurring or Nonrecurring	Fund Affected
PIT (pass through entities)		Up to ($6,000.0)**	Up to ($6,000.0)**	Up to ($6,000.0)**	Up to ($6,000.0)**	Recurring	General Fund
CIT		Up to ($6,000.0)**	Up to ($6,000.0)**	Up to ($6,000.0)**	Up to ($6,000.0)**	Recurring	General Fund

Parentheses ( ) indicate revenue decreases.
** 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)

Agency/Program	FY24	FY25	FY26	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
TRD		$19.5		$19.5	Recurring	General Fund

Parentheses ( ) indicate expenditure decreases.

Sources of Information
LFC Files
LFC FIR on 2023's SB221

Agency Analysis Received From
Taxation and Revenue Department (TRD)
Department of Transportation (NMDOT)

SUMMARY

Synopsis of Senate Bill 28

Senate Bill 28 creates a new section of the Income Tax Act and mirrors these provisions with a companion section of the Corporate Income Tax Act providing the "Rail Infrastructure Income Tax Credit" for a taxpayer that is a class II or class III railroad or the owner or lease of a rail siding, yard or track, or an industrial spur. For both Corporate Income Tax (CIT) and Personal Income Tax (PIT), the credits are equal to 50 percent of a taxpayer's reconstruction or replacement expenditures or qualified new rail infrastructure expenditures. The certification for these credits is done by the Department of Transportation (NMDOT) that may certify a maximum of $6 million per calendar year under the PIT provisions and separately under the CIT provisions. In each case, with the total amount of allowed credits for qualified new rail infrastructure in a calendar year capped at $5 million, leaving at least $1 million for reconstruction or replacement credits. The bill also amends Section 7-1-8.8 NMSA 1978 to allow for information sharing between the Taxation and Revenue Department (TRD) and NMDOT. Credits may be sold or otherwise transferred or carried forward for up to five years.

This bill does not contain an effective date and, as a result, would go into effect 90 days after the Legislature adjourns, or May 15, 2024, if enacted. The provisions are applicable for tax years beginning January 1, 2024. The provisions expire for construction after January 1, 2035.

FISCAL IMPLICATIONS

This bill creates or expands a tax expenditure. Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

TRD notes the following fiscal consequences:

> New Mexico's major rail companies have several ongoing and upcoming initiatives to improve rail connectivity, enhance freight movement, and support economic growth. The Belen Yard, a prominent New Mexico rail hub, is a junction for multiple freight rail lines. Plans are underway to expand and modernize the yard to accommodate increased freight traffic, improve operational efficiency, and support economic development in the region. Double-tracking initiatives aim to add a second track along certain sections of existing rail lines. This expansion improves capacity, allows faster and more efficient train movements, and supports increased freight and passenger rail service. Some upcoming double-tracking projects in New Mexico include portions of the Burlington Northern and Santa Fe (BNSF) Railway mainline. In summary, New Mexico's rail authorities and transportation agencies have ongoing programs to inspect, repair, and upgrade tracks, bridges, signals, and other essential components of the rail network. These endeavors will capture a significant portion of the tax credits offered in the bill.

While TRD expects credits in the range of $3 million to $6 million annually, LFC shows a maximum of $12 million: $6 million in CIT and $6 million in PIT passthrough entities such as LLCs, Subchapter S corporations, and Master Limited Partnerships

Although the Bipartisan Infrastructure Act includes $64 billion in rail grants, the bulk of this money will be spent in Eastern states. Small awards may be made in New Mexico, but not for a number of years.[1]

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[1] https://www.whitehouse.gov/briefing-room/statements-releases/2023/11/06/fact-sheet-president-biden-advances-vision-for-world-class-passenger-rail-by-delivering-billions-in-new-funding/#:~:text=Last%20month%2C%20FRA%20announced%20more,Consolidated%20Rail%20Infrastructure%20and%20Safety

SIGNIFICANT ISSUES

TRD notes several policy issues:

> While tax incentives can provide support for industries and encourage specific social and economic behaviors, the high cost of railroad projects makes it unlikely for this tax credit to serve as a significant source of incentive. The proliferation of such incentives adds complexity to the tax code, creating special treatment and exceptions that result in increased tax expenditures and a narrower tax base. This can have a negative impact on the General Fund. Additionally, the introduction of more tax incentives increases the compliance burden on both taxpayers and on TRD This approach of adding complexity and exceptions to the tax code does not align with the principles of sound tax policies.
>
> Rail companies have historically been responsible for maintaining their own business interests. These companies are actively expanding their operations to generate more profit, and it is reasonable to assume that they would continue to do so even without the presence of this tax credit. The credit therefore imposes an unnecessary distortion to economic activity in New Mexico by incentivizing economic activity that would occur even in the absence of the incentive and by providing state subsidies to a mature and profitable business sector.
>
> 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.

NMDOT also notes several issues:

> SB28 would require NMDOT to establish procedures for and subsequently administer a program to both certify eligibility of specific projects for the tax credit and determine the amount of tax credit allowed for each project. Neither of these responsibilities is something that NMDOT currently undertakes, nor are they within the expertise of the NMDOT.
>
> Additionally, SB28 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 2 and Class 3 railroads to claim a tax credit for "qualified railroad track maintenance expenditures" that has essentially the same definition as that used for "qualified reconstruction or replacement expenditures" in SB 28. 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.

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.

ADMINISTRATIVE IMPLICATIONS

NMDOT expects to need additional resources:

> SB28 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.

TRD expects a low impact overall:

> 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 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 $2,900.
>
> Implementing this bill will have a low impact on TRD's Information Technology Division (ITD), approximately 300 hours or about one and a half months and an estimated staff workload cost of $16,550. This implementation will be included in the annual tax year changes.

Estimated Additional Operating Budget Impact*				R or NR**	Fund(s) or Agency Affected
FY24	FY25	FY26	3 Year Total Cost		
--	$16.6	--	$16.6	NR	TRD- ITD staff workload
--	$2.9	--	$2.9	NR	TRD – ASD staff workload

* In thousands of dollars. Parentheses ( ) indicate a cost saving. ** Recurring (R) or Non-Recurring (NR).

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB28 is a duplicate of: SB221, 2023 Session. This may be a companion of HJM1, which asks the congressional delegation to work on funding a rail line from the Navajo Nation to a point between Grants and Gallup.

NMDOT notes that SB28 creates a state tax credit that essentially replicates the federal tax credit found in 26 U.S. § 45G. Although the text of the proposal does not allow stacking of these credits but provides an exclusion from the state credit for any federal credits allowed, this exclusion will be difficult to administer. The relevant exclusion is on page 5, lines 11 through 14 and page 10, line 23 through page 11, line 2.

"Qualified reconstruction or replacement expenditures" does not include expenditures used to generate a federal tax credit or expenditures funded by a state or federal grant."

TECHNICAL ISSUES

LFC notes the PIT credit cap of $6 million on page 3, line 14, is not joined and stands alone from the CIT credit cap of $6 million on page 8, line 12. When the intent is to have a joint cap, then both the PIT cap and CIT will include clear language identifying that intent.

TRD suggests a number of drafting/technical changes:

> In sections 1 and 2 Subsections A, page 1, line 23, and page 6, line 20, the phrase '…a taxpayer that is a railroad' should be clarified to indicate whether it refers to a taxpayer that owns a railroad. Furthermore, it is questionable as to why this credit is included in the personal Income Tax Act; an individual taxpayer, a natural person, cannot be a railroad. Some businesses do file under the personal income tax act, such as LLCs and partnerships; other businesses file under the corporate income tax.
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> Section 1 and Section 2, Subsection A, is not clear on the division for approval. On page 2 line 6 and on page 7 line 3 after "apply" add "with the department of transportation."
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> In sections 1 and 2, Subsection B, the amount of credit is specified. However, it is unclear whether these limits apply to each individual project or if the taxpayer has the option to carry forward any excess credit amounts to subsequent tax years. To provide clarity on this matter, it would be beneficial to include a timeframe within which the taxpayer must apply for the credit, as outlined below and to specify the credit limit per taxpayer:
>
> To address the ambiguity surrounding the application of the credit limits, it is recommended to establish a timeframe within which the taxpayer must apply for the credit. For example, the taxpayer should apply for the credit within the same tax year/calendar year in which the qualified expenditures are incurred. This would help clarify whether the limits apply to each individual project or if any excess credit amounts can be carried forward to subsequent tax years.
>
> In sections 1 and 2, Subsections C, it is directed that the taxpayer should apply for a certificate of eligibility from the NMDOT after completing the project. However, there is no specified deadline mentioned. It would be helpful to include a deadline to provide clarity regarding the timeframe for applying and determining the credits that have not been utilized or certified. For instance, an example of a deadline could be 'The taxpayer shall apply for a certificate of eligibility from the Department of Transportation within one year after completing 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. This will ascertain the taxpayer's eligibility to receive the tax credit as outlined in this section.'
>
> Also in Subsections C, this bill has a cap of $5 million per calendar year for credits for qualified new rail infrastructure only but allows NMDOT to certify $6 million per calendar year regardless of the type of credit. This is not recommended as the full $6 million that is certified by NMDOT must take into account the difference in the types of credits. TRD would not be able to allow all of those certifications to be claimed as the caps do not match between certification and the credits applied.

In sections 1 and 2, Subsections D, the requirements for the certificate include that it must be numbered, include the date of issuance, and specify the amount of the credit. However, it would be beneficial to also include the tax year for which the certificate is eligible. This additional information would help provide clarity and ensure that the certificate is used within the correct tax year.

In sections 1 and 2, Subsections E, the language should clarify that the credit cannot be partially claimed, then sold, exchanged or transferred.

In sections 1 and 2, Subsections F, there is a restriction that requires the taxpayer apply for the certificate and claim the credit within one year from the end of the calendar year in which the expenditures occurred. However, the current requirement of completing the certification after the projects are finished may result in some expenditures being excluded from the credit. To address this issue, it is suggested to revise the language as follows: "In order to be eligible for the tax credit provided by this section, the taxpayer must apply to the department within twelve months following the calendar year in which the qualified expenditures were incurred, and the certificate was issued. The application should be submitted on forms provided by the department and in accordance with the prescribed procedures."

For tax credits, it is not recommended to have a certification process with the NMDOT, the application process with TRD, and the claim on a return with TRD. This creates a lot of steps that can be simplified for the purposes of administration. TRD would suggest that for this credit NMDOT certifies the credit and manages the cap. With NMDOT being required to provide TRD with the certificates of eligibility and specify the amount of credit the taxpayer has been awarded. Then the credit could be claimed on a taxpayer's return. To achieve this, page 4 Subsection G and page 9 Subsection G, should be stricken in full.

In Section 1, Subsection J, and Section 2, Subsection H, it may be advisable to incorporate reporting requirements related to the NMDOT to provide information on the certification process in addition to requiring the taxpayer to report to the TRD as the bill language now states.

In Sections 1 and 2, Subsections J and L, the following terms needs to be defined:

- "rail-served customer;"
- "replacement" and "maintenance" to clarify in the eligibility of the credit; and
- "gross" expenditures" to clarify what is included in expenditures.

OTHER SUBSTANTIVE ISSUES

TRD notes three additional substantive issues:

The bill piggybacks on the classes (Classes II and III are referenced in the bill) defined by the federal surface transportation board (STB). Each year the STB applies a deflator factor to determine classes. There are also many other financial reporting requirements, which may impact the amount of credit.

TRD is now required by Section 7-1-84 NMSA 1978 to compile and present a tax expenditure budget, which includes the number of taxpayers that claim and the amount of claims for a tax expenditure. Credits are seen as a tax expenditure and will be included in this report. For that reason, TRD recommends that on page 5, lines 13 through 21, page 9 line 25, and page 10 lines 1 through 8 are stricken in full.

If at some point, regulations are needed by NMDOT, this legislation does not specifically state that they can promulgate regulations. This may be something that needs to be considered. An example of this language is in Subsection F of Section 7-2-18.19 NMSA 1978, "The Energy, Minerals and Natural Resources Department may issue rules governing the procedure for administering the provisions of this subsection."

In assessing all tax legislation, LFC staff considers whether the proposal is aligned with committee-adopted tax policy principles. Those five principles:

- **Adequacy**: Revenue should be adequate to fund needed government services.
- **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
- **Equity**: Different taxpayers should be treated fairly.
- **Simplicity**: Collection should be simple and easily understood.
- **Accountability**: Preferences should be easy to monitor and evaluate.

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