Statement of

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United States House Ways and Means Committee
Subcommittee on Tax Policy

Hearing on "Post Tax Reform Evaluation of Recently Expired Tax Provisions"
March 14, 2017

I am Judy Petry, President and General Manager of Farmrail, a 349-mile short line railroad in western Oklahoma. I currently serve as Chairwoman of the Board of the American Short Line and Regional Railroad Association (ASLRRA), the trade association representing the nation's **600** Class II and III railroads. These railroads operate in **49 states** over nearly **50,000 miles of track**, or about one third of the nation's railroad network. For large areas of the country, and particularly for small town and rural America, short line service is the only connection to the national railroad network.

A national short line railroad network map is attached.

I am testifying in support of the Short Line Railroad Rehabilitation 45G Tax Credit, first enacted in 2004 and extended six times through 2017. Each time, stand-alone legislation to extend the credit has been one of the most heavily co-sponsored and bipartisan pieces of tax legislation introduced in that Session of Congress. The current legislation, H.R. 721, introduced by Reps Lynn Jenkins and Earl Blumenauer, which would make the credit permanent, has **256** House co-sponsors, including 9 of the 15 members of the Tax Policy Subcommittee convening this hearing. A list of each of those co-sponsors is attached.

Thousands of customers that rely on our service have signed letters or travelled to Washington in testament to the broad benefits of our track infrastructure for the many communities and regions we serve. A collection of quotes from these customers is attached. We have selected a wide variety from across the country to give you a sense of the important relationship between shippers and their short lines. In general, they sound like this: *"Our serving short line railroad is truly a partner for our paper mill. The services provided, including freight haul in and out, daily switches, and rail car maintenance help us keep our mill running successfully day in and day out. It is critical to the 400 plus people employed here that our short line railroad be able to continue to operate successfully."*

A statement from a group they have formed, known as Saving Our Service, is also attached.

The following comments are in reference to the information requested by the Committee in the hearing announcement and by Chairman Brady in a series of public statements:

Is the credit having its intended effect?
The credit was intended to allow short lines to spend more of what they earn rehabilitating track and bridges. Because our task was to bring back to life what were previously under-maintained Class I

branch lines that were headed for abandonment, we invest on average from 25 to 33 percent of our annual revenues back into our railroads, making us one of the most capital intensive industries in the country. At the same time, due to the relatively short distances involved in most short line routes, revenues on short lines are limited. This is why the short line 45G tax credit is so important. Since enactment, the credit has allowed us to spend an additional $2.1 billion of our earned revenues towards the goal of our getting our network into a state of good repair. It is a critical part of how we can reinvest so much back into our small businesses and still have enough to keep the lights on and meet payrolls.

The credit's unique structure maximizes capital investment in two ways:

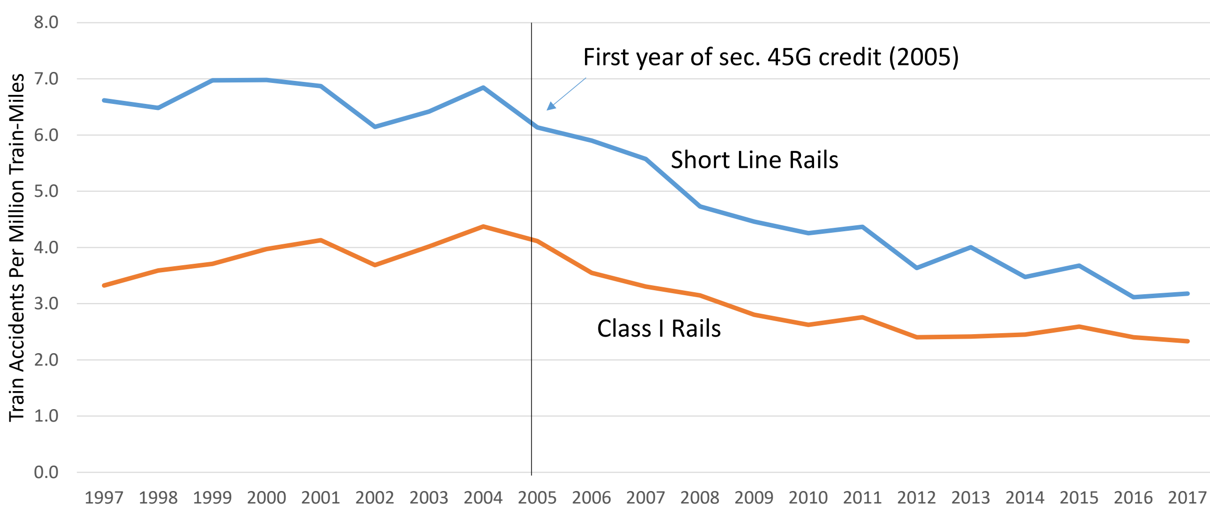
1) 45G requires the railroad to spend two dollars for every dollar in credit, up to the credit cap equivalent of $3,500 per track mile. We have to invest significant amounts into our infrastructure to earn the credit.

2) The ability to assign eligible tax credit miles to a shipper that can use the resulting tax credit allows smaller railroads with insufficient cash flow to fund expensive rehabilitation that would otherwise be out of reach.

Here is one compelling data point that shows that the credit is meeting expectations:
For decades the Railway Tie Association has kept comprehensive statistics on railroad tie purchases. Using econometric modeling and regression analysis that controls for other factors, RTA estimates that the 45G credit results in an average increase of 800,000 short line tie purchases beyond their normalized annual purchases.

And here is another:
One measure of the improved short line railroad infrastructure supported by the 45G credit is improved safety performance. Since enactment of the 45G credit in 2004, train accidents on short line railroads have declined by more than 50 percent, from a rate of 6.84 per million train miles in 2004 to 3.18 in 2017. Short line safety performance is now approaching that of the larger Class I railroads and has improved at a faster rate than Class I railroads over the period the 45G credit has been in existence.

Sec. 45G Credit has Contributed to Improved Safety on Short Line Rails



Notes: Train accidents not at grade crossings; Class I data exclude Amtrak.
Source: Federal Railroad Administration.

What is the overall economic impact of the provision? Is it incentivizing capital investment? How will it amplify the growth and competitiveness delivered by our new tax code?

The credit's overall economic impact and value to the economy is fourfold:

1) Keeping shippers connected to the national freight rail network gives them access to national and global markets which would otherwise be out of reach. It is true that Midwestern grain shippers cannot complete the journey to poultry farm markets in the southeastern United States without Class I railroad service, but it is also true for many that they can't start the journey without short line service.

   America's agricultural, timber, mining, manufacturing (and many more) sectors depend on short line service to get their product on the first mile of its long journey towards its ultimate destination. Without short line service, these job creating sectors would face higher transportation costs and in some cases would no longer be able to stay in business in their current locations, depriving small town and rural America of the jobs they currently provide.

2) Shippers receive substantial competitive benefits by using rail. On my own railroad for instance, the cost of moving the 95 miles from Clinton to Enid, Oklahoma is $2.24 per mile versus $3.75 per mile for comparable truck service. You multiply that by the over 10,000 short line shippers traveling over 50,000 miles of short line track and you are starting to talk about real money.

3) Virtually all the materials we buy to improve our rail lines – wood ties, steel rail, and stone ballast—are made in America.

4) Fifty percent of the cost of a rehabilitated mile of track goes to labor and, as small businesses, we contract out almost all that work to outside companies creating American infrastructure jobs in the process.

As noted, the purpose of the tax credit was to increase capital investment and that has occurred. I will use my own railroad as an example, but these facts can be repeated by virtually every short line in the country. In the last five years Farmrail's annual revenue totaled $84 million and we spent $34 million of that, or just over 40 percent of our revenue, on track improvements. By any measure that is a very high expenditure and $7.7 million of that was made available by the tax credit.

45G incentivizes shippers to invest and they have. In South Dakota, for example, the improvements made by the 670-mile Rapid City, Pierre & Eastern Railroad (RCP&E) since it began operations in 2014 have already attracted over $311 million in new facility investments by six South Dakota companies, creating over 270 new industrial and agricultural sector jobs. For years, shippers would not invest in facilities along the RCP&E's line because of unreliable service and an uncertain future. Then, the track investment and service improvements that were made in part as a result of the 45G credit resulted in increased train speeds, accommodation of industry-standard heavier rail cars, and improved reliability, which changed this reality, restored shipper confidence, and became a catalyst for new industrial development.

This result has been replicated on nearly every short line railroad across the country.

I commend to your attention a recent article by South Dakota Governor Dennis Daugaard on the importance of this investment, a copy of which I have attached to my testimony.

<u>Is the provision still necessary after tax reform? What is the value of keeping the credit in the new tax code?</u>

We believe the recent tax reform legislation benefits American families and businesses and will increase overall economic growth. However, even with the reformed tax code there is still a strong need for the support provided by the 45G credit. While 100-percent expensing will help support capital investment in other industries, it does not serve as a substitute for the 45G credit in the short line railroad industry. Under long-standing IRS rules, 75 percent of most railroad capital track investment could already be immediately expensed. Additionally, much of what we invest in track rehabilitation is considered maintenance expense and could already be immediately deducted. For these two reasons the immediate 100 percent expensing rule does not move the dial much for short lines.

Also, most short lines operate light density lines in rural America that were inherited from their Class I owners with significant deferred maintenance, so the short line owners must now re-invest huge sums, which severely limits pre-tax earnings. Make no mistake: these are viable businesses with significant benefit to the communities and regions they serve. However, the nature of the industry – serving customers who ship in small volumes combined with heavy railroad capital investment requirements, leaves much of the industry with low or no taxable income and hence little benefit from the new lower corporate tax rate.

Since 45G was first enacted in 2004, short lines have used much of the tax credit installing tens of millions of ties to stabilize our most vulnerable track. Going forward, we need to invest approximately $10.8 billion in heavier rail and upgraded bridges to complement that tie replacement and finish the job of upgrading our network to be capable of handling the now industry-standard 286,000 pound rail car.

Finally, as noted above, the ability to assign eligible track miles to a shipper that uses the short line allows smaller railroads with insufficient cash flow to fund expensive rehabilitation that would otherwise be out of reach. This is a unique and very important aspect of the 45G credit that allows short lines with limited income to continue to utilize the credit for its intended purpose.

Although not a question originally posed by the hearing announcement we would be pleased to work with the Ways & Means Committee and the Joint Committee on Taxation to provide industry data on credit usage and assist in projections of the costs and benefits of the credit under possible modifications if the credit were to be made a permanent part of the updated tax code.

I appreciate the opportunity to testify to the benefits of this tax credit and the importance of it being made permanent. On behalf of the entire short line industry let me express our strong desire to work with Congress to ensure that the short line industry remains a vital component of the American transportation network.