

# ***RAILWAYS, TAXATION,***

**AND THE COVID-19 RECOVERY**



Railway Association  
of Canada



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# EXECUTIVE SUMMARY

The COVID-19 pandemic has caused unprecedented impacts on human health, workers, businesses, and governments in Canada and around the world. As the Canadian economy emerges from the pandemic and continues on its path to recovery, now is as an important time as ever for the government to maintain a competitive tax environment. A competitive tax environment will enable the private sector to drive the economic recovery through investment, job creation, and the generation of sustainable tax revenues.

The rail industry is a significant contributor to the Canadian economy and will play a central role in the COVID-19 recovery and Canada's transition to a low-carbon economy. Over the past decade, railways have continued to increase investment into the Canadian network, while generating increased tax revenues for governments.

In 2018, rail contributed \$17.6 billion to Canada's GDP, generated \$7.2 billion in tax revenue, supported 182,000 jobs and lifted incomes by \$10.1 billion. Railways bring over \$320 billion of goods to market each year – over 50% of the country's exports – while contributing to only 3.5% of Canada's transportation GHG emissions.

As one of Canada's most capital-intensive industries, the Railway Association of Canada (RAC) recommends two tax policies to support investment in rail and create economic opportunities for the communities and industries that rely on them:

## **1. Implement 100% Capital Cost Allowance in the first year for all railway assets.**

Canadian railways invest heavily in their networks to compete with railways in the U.S. that enjoy 100% immediate depreciation, and the Canadian trucking sector that benefits from more favourable capital cost allowance rates and operates on publicly funded infrastructure. 100% immediate depreciation for railway assets could incentivize higher levels of investment into modern, fuel-efficient locomotives and safer, lighter, higher-capacity railcars.

## **2. Implement a shortline railway tax credit in Canada that is comparable to the U.S. Section 45G Tax Credit.**

On average, shortline railways are not able to invest as much of their revenues back into track infrastructure as Class 1 railways, and there is currently no dedicated funding or support program for shortline railways at the federal level. Investments in shortline infrastructure improve the fluidity of the transportation system, drive more traffic to the rail network and improve safety while reducing emissions and the strain on public infrastructure. A tax credit program in Canada would cost less than \$25 million per year.

With the implementation of these two tax recommendations, Canada's railways will be able to carry an even greater load in our country's post-pandemic economic recovery.

# ***CONTENTS***

Executive Summary .....	1
Introduction .....	3
Backgrounder on Canada's Railways.....	4
Rail Investment in Canada.....	5
The Importance of Maintaining a Competitive Tax Environment.....	6
Accelerated Capital Cost Allowance for Railway Assets.....	7
Introduce a Shortline Tax Credit.....	9
Conclusion.....	13
Contact .....	13
More on the Railway Association of Canada.....	14
Recommended Reading .....	14

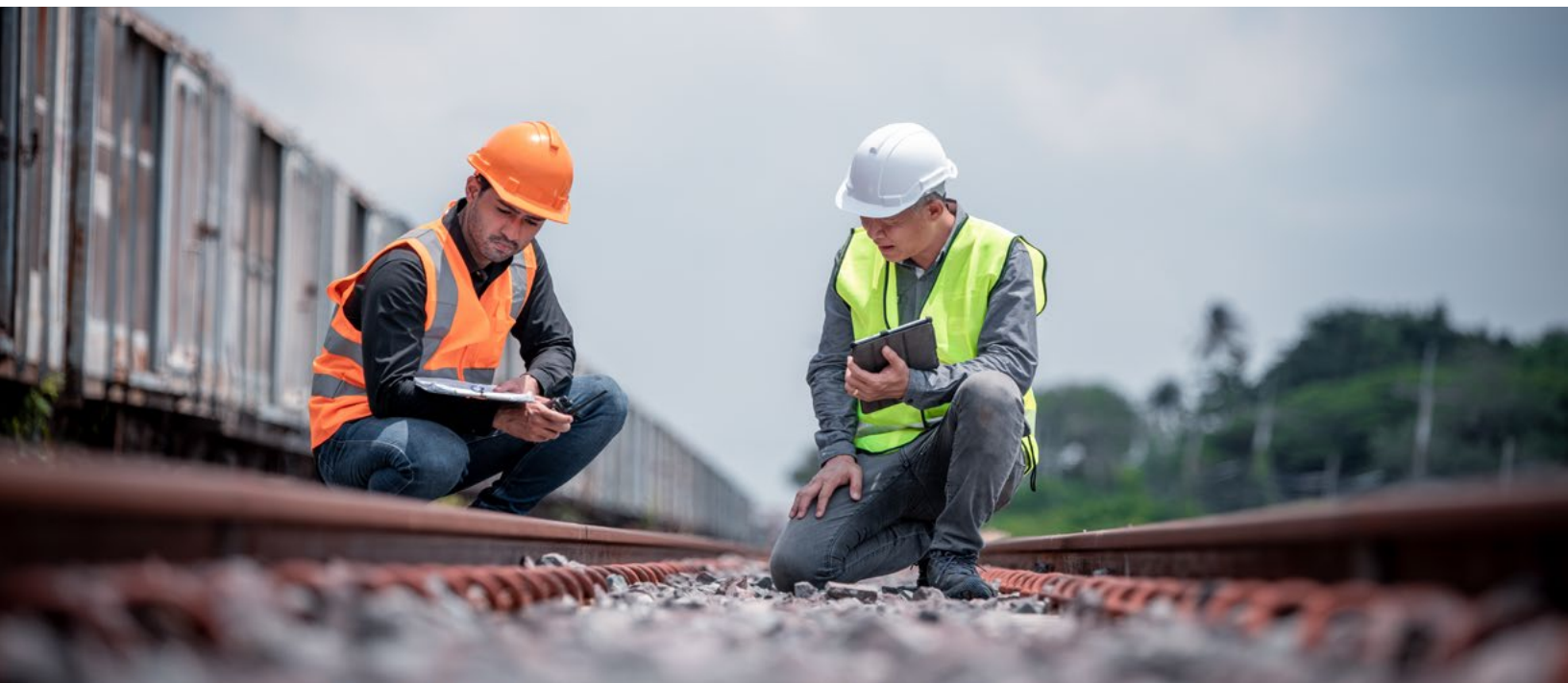
## INTRODUCTION

The COVID-19 pandemic has caused unprecedented impacts on human health, workers, businesses, and governments in Canada and around the world. To emerge from the downturn, the private sector will play a crucial role in the recovery and achieving the government's goal of creating beyond a million jobs.

At this time, the federal government has a real opportunity to leverage tax policy to get shovels in the ground and the economy moving forward. Tax policies that support investment in rail will help kickstart the economy, create opportunities for communities and industries served by rail, and set Canada on the right track toward achieving its ambitious climate targets.

**The what and the why** – What? Tax policy that supports investment in rail equipment and infrastructure. Specifically, 100% capital cost allowance in the first year and the creation of a shortline tax credit.

Why? Recovery from the COVID-19 pandemic is dependent on the growth of the private sector. Supporting investments in rail will help kickstart the economy, create economic opportunities for communities and industries served by rail, and set Canada on the right track toward achieving its ambitious climate targets.





## BACKGROUNDER ON CANADA'S RAILWAYS

Rail is the backbone of Canada's economy, which makes it central to the COVID-19 recovery as well as Canada's transition to a low-carbon economy.

Today, Canada's railways move over 360 million tonnes, or 5.5 million carloads, of freight traffic and over 100 million passengers annually.<sup>1</sup> Canadian railways support nearly every sector of the economy, from agriculture to energy to manufacturing, bringing over \$320 billion of goods to market each year.

Through its transborder North American network and connections to multiple East and West coast ports, the rail industry helps Canada go global. In fact, Canada's railways move 70% of all inter-city traffic and 50% of the country's exports.<sup>2</sup>

Despite the significant volumes, railways produce just 1 percent of Canada's total GHG emissions and only 3.5 percent of Canada's transportation related GHG emissions. To put this efficiency into perspective, railways can move 1 tonne of goods 215 kilometres on a single litre of fuel; and shifting just 10% of truck traffic to rail would reduce Canada's emissions by 4.1 Megatonnes of CO<sub>2</sub>e per year.

Through its [economic footprint](#), rail is a significant contributor to Canada's prosperity. In 2018, the rail industry contributed \$17.6 billion to Canada's GDP, lifted incomes by \$10.1 billion, and generated \$7.2 billion in revenues for the federal and provincial/territorial governments. And rail is a job creator – every 1 job in the rail industry supports nearly 5 additional jobs. In 2018, the rail industry sustained a total of 182,000 jobs in Canada.

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<sup>1</sup> In 2019, Canadian railways transported 107.6 million passengers. In 2020, there were fewer than 100 million rail passengers due to the impacts of the COVID-19 pandemic.

<sup>2</sup> Over 50% by volume. The figure includes rail exports as well as rail-marine exports (Transport Canada, Transportation in Canada, 2020, Statistical Addendum).

## RAIL INVESTMENT IN CANADA

There is a real opportunity for the federal government to leverage tax policy to kickstart the economy and get shovels in the ground today, increase stock of low-carbon infrastructure, and generate new economic opportunities for communities and industries served by rail.

It is important to acknowledge that rail is one of Canada's most capital-intensive industries. The industry is vertically integrated – owning and maintaining the real estate, track, infrastructure, rolling stock (e.g., locomotives and railcars) and equipment.

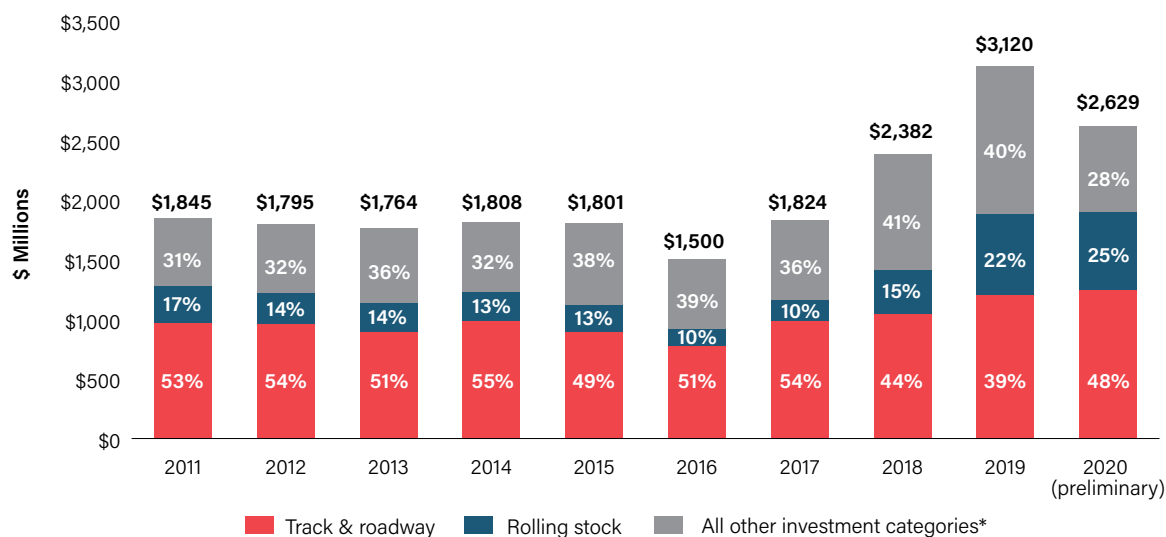
Every year, railways invest between 20 and 25 per cent of their own revenues back into maintaining and enhancing their 43,000 km network – which is, in fact, larger than Canada's 38,000 km National Highway System.<sup>3</sup>

Over the past decade, RAC members have invested over \$20 billion (\$3.1 billion in 2019 alone) into their Canadian networks.

Railways compete directly with a trucking sector that operates on publicly funded infrastructure. From 2011 to 2020, the rail industry's capital expenditures were greater than those of many other transportation industries, including truck transportation, air transportation, and water transportation.<sup>4</sup>

As seen in the figure below, approximately half of all rail investment is in track and roadway. In recent years, about one quarter of investments have been dedicated to rolling stock, including the acquisition of modern, fuel-efficient locomotives, and retrofitting existing locomotives to improve fuel efficiency and reduce emissions.

### Investments in Canadian Rail Assets



Note: Other investment categories include building & related machinery & equipment; signals, communications & power; terminals & fuel stations; intermodal equipment; work equipment & roadway machines; and other equipment.

Source: Railway Association of Canada

<sup>3</sup> Canada's National Highway System Annual Report 2017.

<sup>4</sup> Statistics Canada, Annual Capital and Repair Expenditures Survey: Actual, Preliminary Actual and Intentions

## THE IMPORTANCE OF MAINTAINING A COMPETITIVE TAX ENVIRONMENT

While governments around the world are dealing with fiscal pressures, now is as an important time as ever for Canada to maintain a competitive tax environment.

In recent years, Canada's investment performance has been weak. Among OECD countries, Canada had the fourth-lowest growth in fixed capital formation since 2015.<sup>5</sup> Over this time, Canada's average federal-provincial Corporate Income Tax (CIT) rate was lowered by just 0.5 percentage points, while the OECD average improved by 6.1 percentage points – eroding Canada's tax advantage.<sup>6</sup> In 2020, Canada's federal-provincial CIT rate averaged 26.1%, which was above the U.S. rate of 25.7% and OECD average of 25.8%.<sup>7</sup>

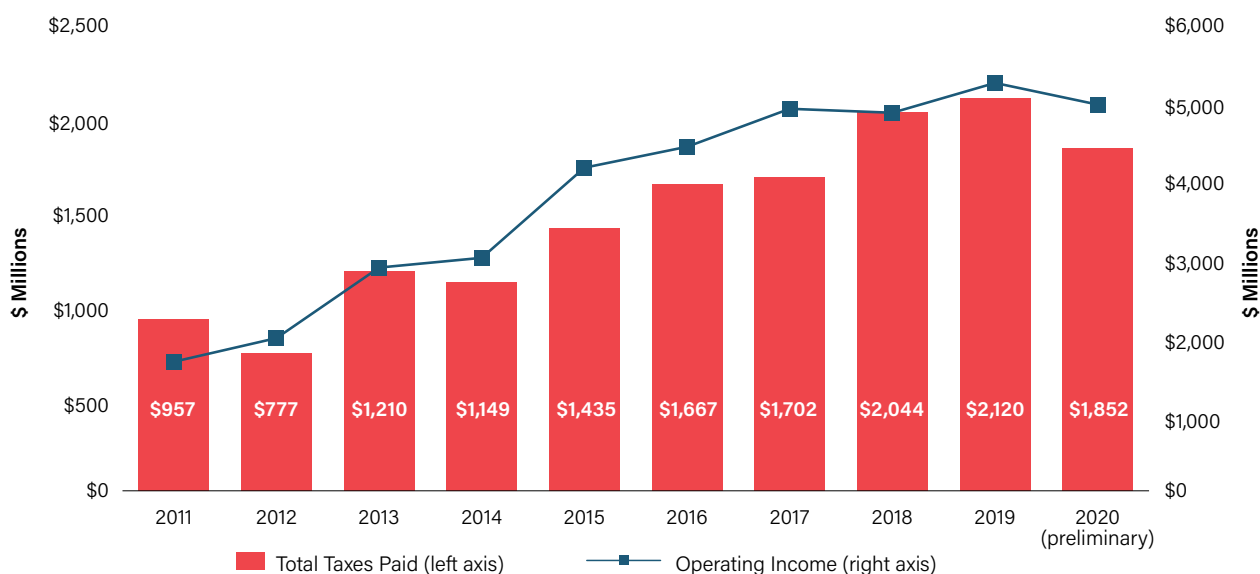
To create sustainable, long-term tax revenues, Canada must ensure that its tax environment remains competitive and that companies can maintain profitability. Bazel & Mintz, authorities on taxation and competitiveness, argue that Canada's corporate tax policy should focus on growth and productivity.<sup>8</sup>

Railways are significant contributors to federal and provincial coffers. In recent years, railways have directly contributed an average of \$2 billion per year in taxes. Through the industry's economic footprint, by lifting GDP and incomes in other sectors, rail contributed \$7.2 billion to government revenues in 2018.<sup>9</sup>

Maintaining the profitability of the rail industry allows the sector to continue to reinvest in its network and increase economic activity in other sectors, generating long-term, sustainable tax revenues to support the recovery.

As can be seen in the graph below, tax revenues generated by the rail industry are strongly linked to its operating income.

### Railway Operating Income and Total Taxes Paid



Source: Railway Association of Canada

<sup>5</sup> University of Calgary, School of Public Policy Publications, 2020 Tax Competitiveness report: Canada's Investment Challenge, September 2021.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid. The OECD average is GDP-weighted.

<sup>8</sup> Ibid.

<sup>9</sup> The Conference Board of Canada, Moving People, Products, and the Economy, April 2020.

## ACCELERATED CAPITAL COST ALLOWANCE FOR RAILWAY ASSETS

Private sector investment and growth will be critical for creating beyond a million jobs and generating the necessary tax revenues to support the government's planned, new investments of approximately \$16 billion per year.<sup>10</sup>

One of the best tried and tested options for the federal government to boost investment and spur economic opportunity is to implement 100% Capital Cost Allowance (CCA) in the first year for all railway assets. Compared to the United States, we are already behind. In December 2017, the U.S. Tax Cuts and Jobs Act (TCJA) was signed into law, which introduced 100% immediate depreciation for assets acquired and placed in service between September 27, 2017, and January 1, 2023. In November 2018, Canada responded by introducing the Accelerated Investment Incentive. However, the Accelerated Investment Incentive did not level the playing field with the U.S., particularly for the Canadian railway industry.

The U.S. TCJA and Canada's Accelerated Investment Incentive effectively made it more attractive to invest in U.S. railways compared to Canadian railways; as well as more attractive to invest in Canadian manufacturing & processing, and other modes of freight transportation such as trucking, compared to Canadian rail. If these tax imbalances persist, important investments and economic recovery opportunities may be lost. Furthermore, investments in rail are key to decarbonizing Canada's transportation sector and achieving 40-45% GHG reductions by 2030 and net zero in 2050.

The table below highlights the differences between the current Canadian and U.S. tax regimes as they relate to railway capital cost allowance; and the tax treatment of railways versus select capital-intensive industries in Canada.

### Tax Treatment of Canadian Railways vs U.S. Railways and Select Canadian Industries

	Canadian Railways		U.S. Railways		Canadian Trucking Industry		Cdn Manufacturing & Processing (M&P)	
	Class Rates	CCA Claimed	Class Rates	CCA Claimed	Class Rates	CCA Claimed	Class Rates	CCA Claimed
	Track Infrastructure		Track Infrastructure		N/A*		M&P Plant	
Year 1	10%	15%	100%	100%			10%	15%
Total by Year 4		38%		100%				38%
	Rail Yard Facility (Building)		Rail Yard Facility (Building)		N/A		N/A	
Year 1	4%	6%	100%	100%				
Total by Year 4		17%		100%				
	Railcars		Railcars		Trailers		M&P Kiln/tank/vat	
Year 1	15%	23%	100%	100%	30%	45%	100%	100%
Total by Year 4		52%		100%		81%		100%
	Locomotives		Locomotives		Hauling trucks		M&P Equipment	
Year 1	30%	45%	100%	100%	40%	60%	100%	100%
Total by Year 4		81%		100%		91%		100%

\*As infrastructure used to move freight (inter-provincial roads) for the trucking industry is already fully funded by the Government.

<sup>10</sup> <https://liberal.ca/wp-content/uploads/sites/292/2021/09/Forward-For-Everyone-Financial-and-Costing-Plan.pdf>



As can be seen, U.S. railways enjoy 100% immediate depreciation on track infrastructure, buildings, railcars, and locomotives.

In Canada, class rates for railcars (15%) and locomotives (30%) are less favourable compared to trailers (30%) and hauling trucks (40%) in the trucking industry. This imbalance between the two main forms of freight ground transportation is not in line with Canada's goal of reducing transportation sector GHG emissions. While commercially viable zero-emissions propulsion options are not available for widespread-adoption by Canadian freight railways today, a fairer CCA rate could incentivize higher levels of investment into modern, fuel-efficient locomotives and safer, lighter, higher-capacity railcars. There are also various pilot projects, from both Class 1s and shortline railways, exploring the viability of hydrogen locomotives for line-haul and switching operations. Lastly, the class rate for railway track infrastructure is very low at 10%, especially compared to its trucking competitors that operate on publicly funded road infrastructure.

Railways are significant contributors to governments' carbon pricing revenues, but the proceeds are not being leveraged to support decarbonization of the transportation sector. At \$50 per tonne of CO<sub>2</sub>e, railways will contribute approximately \$330 million in carbon revenues for governments; at \$170 per tonne that amount rises to approximately \$1.14 billion. However, approximately 90% of the proceeds from the federal government's carbon pollution pricing system are redistributed through the Climate Action Incentive payments to households; and very little of the other 10% is made available for businesses to support investments in GHG reductions.<sup>11</sup>

Since there are few supports available for railway investment in GHG-reducing technologies, 100% CCA for all railway assets is a viable solution and could help free up some funds for railways to continue piloting zero-emissions options.

**Recommendation #1:** Implement 100% Capital Cost Allowance in the first year for all railway assets.

<sup>11</sup> <https://www.canada.ca/en/department-finance/news/2020/12/climate-action-incentive-payment-amounts-for-2021.html>

## **INTRODUCE A SHORTLINE TAX CREDIT**

### **WHAT ARE SHORTLINE RAILWAYS AND WHY ARE THEY IMPORTANT?**

In contrast to Class 1 railways, shortline railways are those that have less than \$250 million in annual revenues. Shortline railways provide essential low-cost, low-emissions first- and last-mile services to Canada's rural and remote communities and industries.

Shortlines bring approximately \$35 billion worth of local Canadian products to world markets efficiently. In fact, 1 in 5 carloads originate on a shortline railway in Canada.

The sustainability of shortline rail in Canada is critical, as many of the supported businesses simply wouldn't exist or couldn't survive without direct access to rail. The alternative to shortline railways, trucking, places more strain on public infrastructure (degradation; congestion) and results in higher GHG emissions.

### **WHY IS IT DIFFICULT FOR SHORTLINE RAILWAYS TO INVEST IN TRACK INFRASTRUCTURE?**

In many cases, shortlines were created as the result of divestment by Class 1 railways of the least profitable parts of their networks.

On average, shortline railways are not able to invest as much of their revenues back into track infrastructure as Class 1s. The average operating ratio (operating expense to operating revenue) of shortline railways in Canada is around 90%, compared to around 60% for the Class 1s.

In Canada, shortlines receive only around 6% of total freight railway operating revenues, and less than 3% of operating income, yet they maintain and operate 19% of the total track miles (8,155kms in 2019). To make matters even more challenging, over the past few years, shortlines have faced rising costs, including wage growth, escalating carbon taxes, and costs stemming from new regulatory requirements (such as grade crossing regulations, safety management systems, and increases to insurance coverage requirements).

There is currently no dedicated funding or support program for shortline railways at the federal level, and very few at the provincial level.

## WHAT NEEDS TO BE DONE?

The creation of a federal tax credit, similar to the Section 45G Tax Credit in the U.S., is needed so that the numerous benefits of shortline railways can continue to be enjoyed by the communities and businesses that rely on them.

The need to support shortline infrastructure investment has been recognized in the U.S. through the Shortline Section 45G Tax Credit<sup>12</sup>, which allows a credit of 50 cents for each dollar invested in track and bridge improvements. On December 27th, 2020, the U.S. COVID-19 relief and government funding Bill was signed, making the Credit permanent.<sup>13</sup> The credit is capped at \$3,500 USD per mile of track operated by each shortline.

■ The estimated cost of such a tax credit in Canada is less than \$25 million CAD per year.<sup>14</sup>

This is a relatively small amount compared to the billions of dollars poured into maintaining road infrastructure every year by municipalities, the federal and provincial governments.<sup>15</sup>

In the U.S., the tax credit is viewed simply as good public policy and has enjoyed strong bipartisan support<sup>16</sup> – and for good reason. Since the credit became effective on January 1, 2005, it has spurred \$5 billion USD in shortline infrastructure investment.

Studies show that the tax credit, by reducing the user's cost of capital, is associated with a 47% increase in investment. Since the credit came into force, shortline railways' purchases of rail ties increased significantly, and at a more rapid rate than the Class 1s. This contributed to a 50% improvement in safety (as measured by the Federal Railroad Administration's rate of train derailments).

<sup>12</sup> [http://files.aslrra.org/images/news\\_file/2020\\_ShortLineTaxCredit\\_Transportation\\_Bill.pdf](http://files.aslrra.org/images/news_file/2020_ShortLineTaxCredit_Transportation_Bill.pdf)

<sup>13</sup> When the Credit becomes permanent in 2023, it will be modified from providing 50 cents for each dollar invested to 40 cents.

<sup>14</sup> In 2019, shortlines operated 8,155km of track in Canada, or 5,068 miles. At a USD:CAD exchange rate of 1.3269 (source: Bank of Canada), the cap per mile of \$3,500 USD is equivalent to \$4,644 CAD. Therefore, the maximum cost of the program in Canada in 2019 is: 5,068 \* \$4,644 = \$23.5 million.

<sup>15</sup> [Transport Canada, Transportation in Canada 2020, Statistical Addendum.](#)

<sup>16</sup> [Over 100 democrats and over 100 republicans are on record saying that the program should be made permanent.](#)

## WHAT ARE THE BENEFITS OF SUPPORTING SHORTLINE INVESTMENT IN CANADA?

The calls to support shortline infrastructure investments in Canada are not new. In December 2018, the Report of the Standing Committee on Finance, *Cultivating Competitiveness: Helping Canadians Succeed*, recommended the following<sup>17</sup>:

### FINA Recommendation 16

Provide significant and sustained funding for short line rail infrastructure improvements to ensure their continued critical role in Canada's transportation networks, facilitate export capacity and improve safety.

**Safety Improvements:** Investments in infrastructure, such as bringing rails and bridges up to modern standards, will improve the safety of the freight transportation system. Following the implementation of the U.S. tax credit (2005), the Federal Railroad Administration's data shows a 50% reduction in shortline train derailments per train mile.

**Increase Network Capacity and Improve Fluidity:** Infrastructure investments that increase shortline rail's capacity can in turn increase the amount of freight that is moved by rail. Many shortline rails do not meet Class 1 weight standards of 286,000 lbs, which limits capacity and hinders the performance and fluidity of the overall supply chain. Track capacity upgrades are very expensive but are necessary to support the country's transition to a low-carbon transportation system.

**Opportunities for communities and shippers:** Shortline railways, through their connections to ports and the Class 1 mainline network, are the critical links that connect remote and rural economies to national and international markets.

Each year, approximately \$35 billion of local goods are brought to market on shortline railways. Freight transportation rates are competitive. From 1988 to 2019, rail freight rates increased by only 39%, which is lower than the 60% increase in commodity prices, 69% increase in the industrial product price index, and 91% increase in the consumer price index.

As a low-cost transportation option, shippers' access to rail provides opportunities for growth and can enhance a region's competitiveness. In fact, many businesses simply wouldn't exist today without their direct access to rail.

**Emissions reductions:** Freight rail is the most fuel-efficient form of ground transportation. As investments in shortline infrastructure drive more traffic to the rail network, the modal shift away from trucks will result in less overall GHG emissions. Shifting just 10% of truck traffic to rail would reduce Canada's emissions by 4.1 Megatonnes of CO<sub>2</sub>e per year.

<sup>17</sup> <https://www.ourcommons.ca/DocumentViewer/en/42-1/FINA/meeting-168/evidence#Int-10264199>;  
<https://www.ourcommons.ca/Content/Committee/421/FINA/Reports/RP10260416/finarp27/finarp27-e.pdf>

**Reduce trucking:** As modal shift occurs, the reduction in truck traffic reduces the strain on publicly funded roads, reducing the financial burden on municipalities, the federal and provincial governments. This is especially important following the COVID-19 pandemic, at a time when public finances are under significant pressure. In addition to the direct cost savings, other negative externalities such as road congestion and pollution can be reduced.

The RAC strongly recommends that the federal government implement a tax credit that is comparable to the U.S. Section 45G Tax Credit as soon as possible. The tax credit is the least administratively burdensome option, it is transparent and provides certainty for shortlines, which unlocks investment today.

**Recommendation #2:** Implement a shortline railway tax credit in Canada that is comparable to the U.S. Section 45G Tax Credit.





## CONCLUSION

As Canada emerges from the COVID-19 pandemic, the private sector will play a critical role in creating more than a million jobs and building back better. While the federal government is dealing with fiscal pressures, it is important to maintain a competitive tax environment that incentivizes investment, growth, and long-term sustainability.

The Railway Association of Canada (RAC) recommends two tax policies to support investment in rail:

**1. Implement 100% Capital Cost Allowance in the first year for all railway assets.** Despite being a GHG-efficient mode of transportation, investments in railway infrastructure and equipment have not benefitted from the *full expensing for manufacturing and processing machinery and equipment or the full expensing for clean energy equipment*. Also, as it currently stands, class rates are less favourable for investments in rail compared to trucking, and rail investments in the U.S. continue to enjoy 100% immediate depreciation.

**2. Implement a shortline railway tax credit in Canada that is comparable to the U.S. Section 45G Tax Credit.** Investments in shortline infrastructure improve the fluidity of the transportation system, drive more traffic to the rail network and improve safety while reducing emissions and the strain on public infrastructure.

With the implementation of these two tax recommendations, Canada's railways will be able to carry an even greater load in our country's post-pandemic economic recovery.

## CONTACT

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## MORE ON THE RAILWAY ASSOCIATION OF CANADA

The Railway Association of Canada (RAC) was established in 1917 and represents close to 60 freight and passenger railway companies. RAC also counts a growing number of industrial railways and railway supply companies in its associate membership. As part of the fifth largest rail network in the world, RAC members are the backbone of Canada's transportation system. We encourage you to visit: <https://www.railcan.ca>

## RECOMMENDED READING

1. [The Conference Board of Canada, Moving People, Products, and the Economy, April 2020.](#)
2. [CPCS, Review of Canadian Short Line Funding Needs and Opportunities, February 26, 2015.](#)
3. [pwc, The Section 45G Tax Credit and the Economic Contribution of the Short Line Railroad Industry, July 2018.](#)
4. [University of Calgary, School of Public Policy Publications, 2020 Tax Competitiveness report: Canada's Investment Challenge, September 2021.](#)