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SURFACE TRANSPORTATION BOARD

DECISION

STB Ex Parte No. 646 (Sub-No. 2)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES— TAXES IN REVENUE SHORTFALL ALLOCATION METHOD

Decided: November 20, 2008

BY THE BOARD:

We find that there is a material error in the Revenue Shortfall Allocation Method (RSAM) formula described in Simplified Standards For Rail Rate Cases, STB Ex Parte No. 646 (Sub-No. 1) (STB served Sept. 5, 2007), (Simplified Standards) in its failure to account for federal and state taxes, and revise the formula to correct this error.

BACKGROUND

RSAM is one of three benchmarks that together are used to determine the reasonableness of a challenged rail rate under the Board's "Three-Benchmark" approach available for small disputes. RSAM is intended to measure the average markup that the railroad would need to collect from all of its "potentially captive traffic" (traffic with a ratio of revenues to variable costs above 180%) to earn adequate revenues as measured by the Board under 49 U.S.C. 10704(a)(2) (i.e., earn a return on investment equal to the railroad industry's cost of capital).

In Simplified Standards, the Board changed the way the RSAM benchmark is calculated to address a flaw the agency had identified in that formula.[1] Under the RSAM formula as revised in Simplified Standards, the Board uses the confidential Waybill Sample[2] to estimate the

[1] Previously, RSAM had been calculated by computing the uniform markup above variable cost that would be needed from all potentially captive traffic for the carrier to recover all of its fixed costs, as calculated using the Board's Uniform Rail Costing System (URCS). Rate Guidelines—Non-Coal Proceedings, 1 S.T.B. 1004, 1027 (1996). When a carrier is not "revenue adequate" under the Board's annual calculations, its RSAM figure (what it needs to collect) should be greater than its $R/VC_{>180}$ figure (what it is actually collecting) and, conversely, when a carrier is "revenue adequate" its RSAM figure should be less than or equal its $R/VC_{>180}$ figure. The problem was that this relationship between RSAM and $R/VC_{>180}$ did not hold true under the Board's prior RSAM computation method. See, e.g., Simplified Standards at 19-20.

[2] The Waybill Sample is a statistical sampling of railroad waybills that is collected and maintained for use by the Board and by the public (with appropriate restrictions to protect the confidentiality of individual traffic data). See 49 CFR 1244.

total revenues earned by the carrier on potentially captive traffic ($REV_{>180}$) and the total variable costs of the railroad to handle that traffic ($VC_{>180}$). The Board also uses the carrier's revenue shortfall (or overage) shown in the Board's annual revenue adequacy determination ($REV_{short/overage}$). RSAM is then calculated as follows:

$$RSAM = (REV_{>180} + REV_{short/overage}) \div VC_{>180}$$

Recent cases have revealed a second flaw that had previously escaped the attention of the parties and the Board: the failure of the RSAM formula to account for taxes. In E.I. DuPont de Nemours & Co. v. CSX Transportation, Inc., STB Docket Nos. 42099, 42100, and 42101 (the DuPont cases), CSX Transportation, Inc. (CSXT) observed that the revenue shortfall ($REV_{short/overage}$)—which is calculated as the difference between the return on net investment that a carrier needs to earn in order to achieve revenue adequacy and the amount that the carrier actually earns—has been calculated after all taxes have been paid, and thus has been stated on an after-tax basis. However, the revenues to which the revenue adequacy shortfall is added ($REV_{>180}$) are calculated before any allowance for taxes, and are thus stated on a pre-tax basis. Therefore, CSXT asserted, the reliance on an after-tax revenue shortfall would not provide sufficient revenues to achieve adequate revenues once the additional revenues are subject to taxes.

CSXT had asked that the Board address this matter in the cases where it was raised.[3] But we determined that it would not be advisable to make an ad hoc adjustment in those individual cases. Instead, we instituted this rulemaking to obtain broader public input on the magnitude of the problem and what, if any, correction to make.

We have received three rounds of public comment on this issue. On opening we received comments from the Association of American Railroads (AAR) and joint comments submitted by: American Chemistry Council; American Forest and Paper Association; American Soybean Association; Agricultural Retailers Association; Colorado Wheat Administrative Committee; Corn Refiners Association; The Fertilizer Institute; Glass Producers Transportation Council; Idaho Barley Commission; Idaho Wheat Commission; Institute of Scrap Recycling Industries; Iowa Soybean Association; Montana Wheat and Barley Committee; National Association of Wheat Growers; National Barley Growers Association; National Corn Growers Association; National Council of Farmers Cooperatives; National Farmers Union; National Grain and Feed Association; National Sorghum Producers; The National Industrial Transportation League; National Oilseed Processors Association; National Petrochemical & Refiners Association; Nebraska Wheat Board; North American Millers Association; North Dakota Grain Dealers Association, North Dakota Pubic Service Commission, North Dakota Wheat Commission; Oklahoma Wheat Commission; Paper and Forest Industry Transportation Committee; PPL

[3] CSXT proposed that the Board change the RSAM formula by applying the Federal statutory tax rate of 35% in conjunction with CSXT's railroad-specific state tax rate of 4.9% to convert the after-tax shortfall to a pre-tax level. But DuPont argued that no adjustment to the RSAM formula was necessary because the revenue adequacy adjustment factor was overstated. Alternatively, DuPont argued that the Board should use an "effective" or "marginal" tax rate, rather than the statutory tax rate advocated by CSXT.

EnergyPlus, LLC; South Dakota Wheat Commission; Texas Wheat Producers Board; USA Rice Federation; Washington Wheat Commission; Alliance for Rail Competition; Consumers United for Rail Equity; and The Honorable Brian Schweitzer, Governor, State of Montana (collectively Interested Parties). We received reply comments from the AAR and rebuttal comments from the Interested Parties.

REVISION TO RSAM

To decide whether and how to correct the RSAM calculation, we must determine: (1) whether there is a problem with the RSAM calculation; (2) if so, whether URCS overstates taxes, making an adjustment to RSAM unnecessary and; (3) if there is a problem with RSAM and URCS does not overstate taxes, how the revenue shortfall should be converted to a pre-tax value.

1. There is a material error in the RSAM formula.

As the AAR has pointed out, the revenue shortfall (or overage) used in the RSAM formula is stated on an after-tax basis, whereas the other elements of the RSAM formula are stated on a pre-tax basis. No party disputes this disparity. Because the RSAM formula improperly mixes pre-tax and after-tax revenues, it does not accurately measure the average markup that the railroad would need to collect from all of its "potentially captive traffic" to earn adequate revenues.

2. An adjustment to RSAM is necessary.

The Interested Parties assert that no adjustment to the RSAM formula is necessary because of a counterbalancing error in the treatment of taxes in URCS. Specifically, they maintain that URCS overstates the railroads' tax liability, which causes an overstatement of the revenue adequacy adjustment factor (RSAM ÷ $R/VC_{>180}$). In support, Interested Parties present an analysis of the Federal taxes paid as reported in the railroads' R-1 reports, to demonstrate that the actual taxes the railroads pay are significantly lower that the 35% tax rate in URCS, and that URCS therefore overstates the railroads' effective Federal tax rates.[4]

On reply, however, AAR expands Interested Parties' analysis to include state and deferred taxes. AAR argues that the amount of taxes that a railroad pays in a particular year is not an appropriate measure of a railroad's tax liability because it ignores a railroad's deferred tax liability—tax liabilities that are incurred by the railroad and included on the railroad's books. AAR shows that when deferred taxes and state taxes are added to the Federal taxes actually paid in a particular year—consistent with Generally Accepted Accounting Principles (GAAP)—the revised "effective tax rate" is close to the railroads' "effective tax rate" as set out in their annual statements.

[4] Interested Parties define an effective tax rate as "the amount of tax an individual or firm pays when all other governmental tax offsets or payments are applied, divided by the tax base." Interested Parties Open., V.S. Crowley at 11-12.

We agree with AAR that the Interested Parties' analysis is flawed because it failed to include state taxes and deferred taxes. In the railroads' financial reporting in the R-1 reports, tax liabilities are recognized on an accrual basis, consistent with GAAP, not on a cash basis. Therefore, deferred taxes must be included in the determination of tax liability, because timing differences result in tax credits or debits. Since the RSAM is dependent on URCS, and URCS is dependent on the R-1 reports, which are consistent with GAAP, Interested Parties erred in only considering Federal taxes in their effective tax rate calculations.

Therefore, we use AAR's analysis, which shows that URCS is not significantly overstating or understating the railroad tax liability. We expanded AAR's analysis to calculate the annual industry-average tax rates, which were then compared to the 35% tax rate used in URCS.[5] The resulting annual industry-average effective tax rates exceed the 35% tax rate used in URCS for all years since 2000, except for 2005. We then calculated the industry-average tax rate from 2000 to 2007 as 35.7% and concluded that the 35% rate used in URCS—a system average cost model—closely approximates the observed rail industry's tax liability.[6]

Moreover, even if taxes were not treated correctly in URCS, that would not be reason to leave a material error in the RSAM formula. In other words, this is not a situation where two wrongs would make a right. There may be merit to using a carrier-specific effective tax rate in URCS. But such issues should be addressed in a separate URCS rulemaking. Here, there is no credible evidence that the treatment of taxes in URCS could support the failure to account for taxes in RSAM.

3. The Newly Revised RSAM Formula

There is broad agreement that RSAM should be adjusted using the marginal tax rate of the carriers, but that the information needed to estimate marginal taxes rates is unavailable. The parties therefore offer two alternatives to approximate the marginal tax rates: the statutory federal tax rate of 35% and a railroad-specific state tax rate (advocated by AAR) or the "effective" tax rate paid by the carrier in a particular year (advocated by Interested Parties).

We conclude that use of the statutory federal tax rate, combined with a railroad-specific state tax rate, is the proper revision to make because it best approximates the marginal taxes the carrier would pay on incremental revenue. Interested Parties' two arguments in favor of using a yearly effective tax rate are unpersuasive. First, they argue that the difference between tax accounting and financial accounting results in deferred taxes that lower the railroads' tax rates below the statutory level. That is, rather than being an issue of timing (when taxes are paid), as AAR maintains, Interested Parties contend that continual investment actually lowers the rate that

[5] We added a column to AAR witness Mr. Baranowski's Exhibit 3 representing the industry-average tax liabilities for each year as the sum of each railroads' tax liability. See Appendix 1.

[6] Because we find that URCS does not overstate the railroads' tax liability, we will not address Interested Parties' analysis and underlying assumptions used in re-costing the Carload Waybill Sample using URCS Phase III models adjusted to use each railroads' effective tax rate instead of the statutory tax rate.

a carrier may pay. In support, Interested Parties provide an analysis of the impact on taxes of the continual installation of assets, and the subsequent continual addition of deferred taxes. Interested Parties state that this drives the effective tax rate over the life of the asset below the statutory tax rate. But that analysis is artificially truncated. When we expanded Interested Parties' analysis to measure the impact of continued installation of assets beyond the 25-year asset life used in Interested Parties' analysis,[7] we found that the annual tax rates are equal to the statutory tax rates every year starting in year 24. Based on this analysis, we find that, even with continual investment, the annual tax rates can equal the statutory tax rates and that the accelerated depreciation only affects the timing of payments.

Second, Interested Parties contend that the revenue received from the RSAM adjustment would likely be reinvested in capital assets that will generate additional deferred tax credits and reduce a railroad's taxes below the statutory level. But it is no answer to simply assume that the revenue required in the RSAM adjustment to achieve revenue adequacy is to be reinvested in capital assets. That assumption would change the railroad's net investment base, which would in turn increase the revenue shortfall (or reduce the overage). To maintain the measured revenue shortfall, the analysis must leave the net investment base unchanged. Thus, the additional revenues necessary to make up the shortfall cannot be assumed to be reinvested. These additional revenues would then be taxed at the statutory tax rate, as they would not generate any new tax deductions or credits to reduce the tax rate below the statutory level.

We will therefore apply the following revised methodology to calculate RSAM. We will continue to use the confidential Waybill Sample to estimate the total revenues earned by the carrier on potentially captive traffic ($REV_{>180}$) and the total variable costs of the railroad to handle that traffic ($VC_{>180}$). We will also continue to use the carrier's revenue shortfall (or overage) shown in the Board's annual revenue adequacy determination ($REV_{short/overage}$). We will then account for taxes by calculating a tax-adjusted shortfall or overage, where the Adjusted $REV_{short/overage} = REV_{short/overage} \div (1 - (\text{State Tax Rate} + (1 - \text{State Tax Rate}) \times \text{Federal Tax Rate}))$. RSAM will then continue be calculated as follows:

$$RSAM = (REV_{>180} + \text{Adjusted } REV_{short/overage}) \div VC_{>180}$$

We propose to calculate a weighted average state tax rate for each railroad using the route-miles of track for each railroad in each state and the state tax rates. However, we do not have all of the necessary information needed to calculate each railroads' average state tax rate. While the AAR argues that its proposal for calculating a railroad-specific weighted-average state tax rate is simple to apply and produces consistent results across all railroads, it does not provide any supporting evidence to calculate those values for the railroads.

We will soon therefore institute a separate proceeding, in which each Class I railroad will be required to submit information regarding the state tax rates incurred in each state in which it has operated from 2002-2007, and on a yearly ongoing basis. In that proceeding, we will propose the railroads use the information in the R-1 Schedule 702 (Miles of Road at Close of Year—By States and Territories (Single Track)) to calculate the route-mile portion of the

[7] See Appendix 2.

average state tax rate equation. Specifically, we propose that they should use column (g) of the R-1 Schedule 702, which is the total miles operated, including both "line owned" and "line operated under trackage rights." As we already collect this information annually from the carriers, we are not imposing any additional reporting requirements.

However, parties will be free in this separate proceeding to comment on this approach for calculating the carrier-specific state tax rates, and the use of the R-1 data for route miles. We will resolve any disputes over the best way to calculate the carrier-specific state tax rates, and publish the new RSAM figures, in that separate proceeding.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. This decision is effective on its service date.

2. Notice of this decision will be published in the Federal Register.

By the Board, Chairman Nottingham, Vice Chairman Mulvey, and Commissioner Buttrey.

Anne K. Quinlan
Acting Secretary

Appendix 1

Class I Effective Tax Rates (All Tax Liability) - 2000 to 2007

	Item	BNSF	CSX	CN/GTW	KCS	NS	CP/SOO	UP	Industry Avg
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	2000								
1	Income (Loss) from Continuing Operations 1/	$ 1,811,713	$ 170,135	$ 177,555	$ 28,408	$ 277,552	$ 46,543	$ 1,419,663	$ 4,109,124
2	Federal Income Taxes 2/	$ 288,319	$ (32,934)	$ 50,318	$ (28,385)	$ 69,725	$ (1,556)	$ 36,192	$ 431,997
3	State Income Taxes 3/ 7/	$ 42,671	$ 5,640	$ 7,164	$ (327)	$ 7,814	$ -	$ 3,238	$ 73,364
4	Other Income Taxes 4/ 7/	$ -	$ 118	$ -	$ 171	$ -	$ -	$ -	$ 289
5	Deferred Annual Taxes 5/ 7/	$ 362,588	$ 99,843	$ 6,350	$ 27,549	$ 19,745	$ 11,577	$ 454,393	$ 988,395
6	Total Tax Liability	$ 693,578	$ 72,667	$ 63,832	$ (992)	$ 97,284	$ 10,021	$ 493,823	$ 1,494,045
7	Post-(State, Other and Deferred) Effective Tax Rate 6/	38.3%	42.7%	36.0%	-3.5%	35.1%	21.5%	34.8%	36.4%
	2001								
1	Income (Loss) from Continuing Operations 1/	$ 1,550,111	$ 324,162	$ 174,508	$ 45,519	$ 535,576	$ 71,465	$ 1,653,148	$ 4,528,997
2	Federal Income Taxes 2/	$ 249,597	$ (10,588)	$ (20,307)	$ (20,890)	$ 110,485	$ 2,087	$ 174,464	$ 464,541
3	State Income Taxes 3/ 7/	$ 29,264	$ 573	$ (3,698)	$ (1,253)	$ 18,420	$ -	$ 10,115	$ 49,723
4	Other Income Taxes 4/ 7/	$ -	$ 66	$ -	$ 103	$ -	$ -	$ -	$ 169
5	Deferred Annual Taxes 5/ 7/	$ 319,288	$ 130,977	$ 99,874	$ 27,490	$ 68,776	$ 18,556	$ 410,873	$ 1,175,708
6	Total Tax Liability	$ 598,149	$ 121,028	$ 75,869	$ 5,450	$ 197,681	$ 20,643	$ 595,452	$ 1,690,141
7	Post-(State, Other and Deferred) Effective Tax Rate 6/	38.6%	37.3%	43.5%	12.0%	36.9%	28.9%	36.0%	37.3%
	2002								
1	Income (Loss) from Continuing Operations 1/	$ 1,531,115	$ 479,373	$ 39,738	$ 69,752	$ 700,202	$ 90,932	$ 2,113,228	$ 5,024,340
2	Federal Income Taxes 2/	$ 114,672	$ (21,488)	$ (21,990)	$ (25,828)	$ 84,794	$ 6,726	$ 192,960	$ 329,846
3	State Income Taxes 3/	$ 14,785	$ (152)	$ 1,029	$ (40)	$ 5,508	$ 2,463	$ 17,407	$ 41,000
4	Other Income Taxes 4/	$ -	$ 78	$ 4,988	$ -	$ -	$ -	$ -	$ 5,066
5	Deferred Annual Taxes 5/	$ 440,817	$ 204,896	$ 34,399	$ 32,692	$ 182,257	$ 23,132	$ 528,831	$ 1,447,024
6	Total Tax Liability	$ 570,274	$ 183,334	$ 18,426	$ 6,824	$ 272,559	$ 32,321	$ 739,198	$ 1,822,936
7	Post-(State, Other and Deferred) Effective Tax Rate 6/	37.2%	38.2%	46.4%	9.8%	38.9%	35.5%	35.0%	36.3%
	2003								
1	Income (Loss) from Continuing Operations 1/	$ 1,520,484	$ 223,439	$ 113,278	$ 26,647	$ 503,461	$ 74,671	$ 1,715,167	$ 4,177,147
2	Federal Income Taxes 2/	$ 96,843	$ (52,704)	$ 4,303	$ -	$ 53,483	$ 7,838	$ 208,064	$ 317,827
3	State Income Taxes 3/	$ 17,864	$ 2,197	$ 4,273	$ 22	$ 7,637	$ 691	$ 43,321	$ 76,005
4	Other Income Taxes 4/	$ -	$ 104	$ 175	$ -	$ -	$ -	$ -	$ 279
5	Deferred Annual Taxes 5/	$ 444,958	$ 129,978	$ 24,468	$ 7,073	$ 129,541	$ 6,439	$ 357,704	$ 1,100,161
6	Total Tax Liability	$ 559,665	$ 79,575	$ 33,219	$ 7,095	$ 190,661	$ 14,968	$ 609,089	$ 1,494,272
7	Post-(State, Other and Deferred) Effective Tax Rate 6/	36.8%	35.6%	29.3%	26.6%	37.9%	20.0%	35.5%	35.8%
	2004								
1	Income (Loss) from Continuing Operations 1/	$ 1,562,569	$ 511,043	$ 274,009	$ 73,133	$ 1,147,620	$ 18,528	$ 823,088	$ 4,409,990
2	Federal Income Taxes 2/	$ 323,745	$ 10,092	$ (8,154)	$ 14,942	$ 147,137	$ 3,909	$ (78,461)	$ 413,210
3	State Income Taxes 3/	$ 49,876	$ 5,002	$ 8,055	$ 5	$ 42,932	$ (560)	$ 2,031	$ 107,341
4	Other Income Taxes 4/	$ -	$ 126	$ 107	$ -	$ -	$ -	$ -	$ 233
5	Deferred Annual Taxes 5/	$ 219,055	$ 169,949	$ 96,899	$ 16,229	$ 200,101	$ 3,965	$ 315,751	$ 1,021,949
6	Total Tax Liability	$ 592,676	$ 185,169	$ 96,907	$ 31,176	$ 390,170	$ 7,314	$ 239,321	$ 1,542,733
7	Post-(State, Other and Deferred) Effective Tax Rate 6/	37.9%	36.2%	35.4%	42.6%	34.0%	39.5%	29.1%	35.0%
	2005								
1	Income (Loss) from Continuing Operations 1/	$ 2,789,258	$ 962,736	$ 469,604	$ 14,299	$ 1,412,758	$ 125,391	$ 1,366,931	$ 7,140,977
2	Federal Income Taxes 2/	$ 762,945	$ 220,345	$ 95,513	$ (2,079)	$ 320,984	$ 3,317	$ 313,447	$ 1,714,472
3	State Income Taxes 3/	$ 100,499	$ 29,058	$ 13,491	$ (2,379)	$ 49,344	$ 483	$ 40,955	$ 231,451
4	Other Income Taxes 4/	$ -	$ 15	$ 354	$ -	$ -	$ -	$ -	$ 369
5	Deferred Annual Taxes 5/	$ 185,441	$ 20,846	$ 48,172	$ 2,437	$ (44,843)	$ 46,153	$ 19,943	$ 278,149
6	Total Tax Liability	$ 1,048,885	$ 270,264	$ 157,530	$ (2,021)	$ 325,485	$ 49,953	$ 374,345	$ 2,224,441
7	Post-(State, Other and Deferred) Effective Tax Rate 6/	37.6%	28.1%	33.5%	-14.1%	23.0%	39.8%	27.4%	31.2%
	2006								
1	Income (Loss) from Continuing Operations 1/	$ 3,476,342	$ 1,464,780	$ 668,186	$ 104,619	$ 1,846,273	$ 181,585	$ 2,383,316	$ 10,125,101
2	Federal Income Taxes 2/	$ 869,232	$ 370,403	$ 147,439	$ 1,376	$ 490,190	$ 33,460	$ 659,738	$ 2,571,838
3	State Income Taxes 3/	$ 114,430	$ 4,868	$ 17,555	$ 432	$ 83,004	$ 7,151	$ 55,486	$ 282,926
4	Other Income Taxes 4/	$ -	$ 242	$ 1,887	$ -	$ -	$ -	$ -	$ 2,129
5	Deferred Annual Taxes 5/	$ 301,329	$ 126,250	$ 97,359	$ 28,280	$ 40,315	$ 32,347	$ 160,303	$ 786,183
6	Total Tax Liability	$ 1,284,991	$ 501,763	$ 264,240	$ 30,088	$ 613,509	$ 72,958	$ 875,527	$ 3,643,076
7	Post-(State, Other and Deferred) Effective Tax Rate 6/	37.0%	34.3%	39.5%	28.8%	33.2%	40.2%	36.7%	36.0%
	2007								
1	Income (Loss) from Continuing Operations 1/	$ 3,509,311	$ 1,600,811	$ 675,516	$ 103,191	$ 1,916,142	$ 219,146	$ 2,881,305	$ 10,905,422
2	Federal Income Taxes 2/	$ 948,305	$ 378,485	$ 122,811	$ -	$ 480,475	$ 36,734	$ 751,638	$ 2,718,448
3	State Income Taxes 3/	$ 132,319	$ 40,636	$ 23,053	$ 545	$ 62,842	$ 5,775	$ 68,136	$ 333,306
4	Other Income Taxes 4/	$ -	$ -	$ -	$ -	$ -	$ -	$ (25,681)	$ (25,681)
5	Deferred Annual Taxes 5/	$ 275,214	$ 190,156	$ 95,802	$ 27,017	$ 147,584	$ 41,553	$ 304,798	$ 1,082,124
6	Total Tax Liability	$ 1,355,838	$ 609,277	$ 241,666	$ 27,562	$ 690,901	$ 84,062	$ 1,098,891	$ 4,108,197
7	Post-(State, Other and Deferred) Effective Tax Rate 6/	38.6%	38.1%	35.8%	26.7%	36.1%	38.4%	38.1%	37.7%

			Industry Avg (2000 to 2007)
1/	Annual Report Form R-1 Schedule 210 Line 46 (b)	Income (Loss) from Continuing Operations	$ 50,421,098
2/	Annual Report Form R-1 Schedule 210 Line 47 (b)	Federal Income Taxes	$ 8,962,179
3/	Annual Report Form R-1 Schedule 210 Line 48 (b)	State Income Taxes	$ 1,195,116
4/	Annual Report Form R-1 Schedule 210 Line 49 (b)	Other Income Taxes	$ (17,147)
5/	Annual Report Form R-1 Schedule 210 Line 50 (b)	Deferred Annual Taxes	$ 7,879,693
6/	Total Tax Liability Income (Loss) From Continuing Operations	Total Tax Liability	$ 18,019,841
7/	These values for CN/GTW include the IC in 2000 and 2001, consistent with the Income from Continuing Operations (Line 1) and Federal Income Taxes (Line 2) values.	Post-(State, Other and Deferred) Effective Tax Rate	**35.7%**

Source: R-1 Reports from STB's website

Appendix 2

Impact on Effective Tax Rate From Continuous Investment

Assumptions

1. Initial Investment $10,000,000
2. Asset Life 25
3. Salvage Percentage 0.00%
4. Constant Statutory Tax Rate 35%
5. Annual Income $2,000,000
6. New Investment is Placed in Service Annually

	Year	Income /1	Straight-Line Depreciation /2	Taxable Income /3	Taxes Based On Accelerated Depreciation /4	Effective Tax Rate /5	Assets in Place
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
7.	1	$ 2,000,000	$ 400,000	$ 1,600,000	$ 525,000	33%	1
8.	2	$ 4,000,000	$ 800,000	$ 3,200,000	$ 892,500	28%	2
9.	3	$ 6,000,000	$ 1,200,000	$ 4,800,000	$ 1,293,250	27%	3
10.	4	$ 8,000,000	$ 1,600,000	$ 6,400,000	$ 1,723,750	27%	4
11.	5	$ 10,000,000	$ 2,000,000	$ 8,000,000	$ 2,181,200	27%	5
12.	6	$ 12,000,000	$ 2,400,000	$ 9,600,000	$ 2,663,150	28%	6
13.	7	$ 14,000,000	$ 2,800,000	$ 11,200,000	$ 3,156,650	28%	7
14.	8	$ 16,000,000	$ 3,200,000	$ 12,800,000	$ 3,650,150	29%	8
15.	9	$ 18,000,000	$ 3,600,000	$ 14,400,000	$ 4,143,300	29%	9
16.	10	$ 20,000,000	$ 4,000,000	$ 16,000,000	$ 4,636,800	29%	10
17.	11	$ 22,000,000	$ 4,400,000	$ 17,600,000	$ 5,129,950	29%	11
18.	12	$ 24,000,000	$ 4,800,000	$ 19,200,000	$ 5,623,450	29%	12
19.	13	$ 26,000,000	$ 5,200,000	$ 20,800,000	$ 6,116,600	29%	13
20.	14	$ 28,000,000	$ 5,600,000	$ 22,400,000	$ 6,610,100	30%	14
21.	15	$ 30,000,000	$ 6,000,000	$ 24,000,000	$ 7,103,250	30%	15
22.	16	$ 32,000,000	$ 6,400,000	$ 25,600,000	$ 7,700,000	30%	16
23.	17	$ 34,000,000	$ 6,800,000	$ 27,200,000	$ 8,400,000	31%	17
24.	18	$ 36,000,000	$ 7,200,000	$ 28,800,000	$ 9,100,000	32%	18
25.	19	$ 38,000,000	$ 7,600,000	$ 30,400,000	$ 9,800,000	32%	19
26.	20	$ 40,000,000	$ 8,000,000	$ 32,000,000	$ 10,500,000	33%	20
27.	21	$ 42,000,000	$ 8,400,000	$ 33,600,000	$ 11,200,000	33%	21
28.	22	$ 44,000,000	$ 8,800,000	$ 35,200,000	$ 11,900,000	34%	22
29.	23	$ 46,000,000	$ 9,200,000	$ 36,800,000	$ 12,600,000	34%	23
30.	24	$ 48,000,000	$ 9,600,000	$ 38,400,000	$ 13,300,000	35%	24
31.	25	$ 50,000,000	$ 10,000,000	$ 40,000,000	$ 14,000,000	35%	25
32.	26	$ 50,000,000	$ 10,000,000	$ 40,000,000	$ 14,000,000	35%	25
33.	27	$ 50,000,000	$ 10,000,000	$ 40,000,000	$ 14,000,000	35%	25
34.	28	$ 50,000,000	$ 10,000,000	$ 40,000,000	$ 14,000,000	35%	25
35.	29	$ 50,000,000	$ 10,000,000	$ 40,000,000	$ 14,000,000	35%	25
36.	30	$ 50,000,000	$ 10,000,000	$ 40,000,000	$ 14,000,000	35%	25
37.	31	$ 50,000,000	$ 10,000,000	$ 40,000,000	$ 14,000,000	35%	25
38.	32	$ 50,000,000	$ 10,000,000	$ 40,000,000	$ 14,000,000	35%	25
39.	33	$ 50,000,000	$ 10,000,000	$ 40,000,000	$ 14,000,000	35%	25
40.	34	$ 50,000,000	$ 10,000,000	$ 40,000,000	$ 14,000,000	35%	25
41.	35	$ 50,000,000	$ 10,000,000	$ 40,000,000	$ 14,000,000	35%	25
42.	Total /6			$ 920,000,000	$ 303,949,100	33%	

1. *Line 5 x Column (7). This assumes each new asset added contributes $2 million in income.*
2. *Line 1 / Line 2 x Column (7). This assumes each new asset has costs $10 million and has a 25 year life.*
3. *Column (2) - Column (3)*
4. *The cumulative sum of Baranowski's Exhibit No. 4, Column (6). The represents the taxes payable each year with the benefits of accelerated depreciation.*
5. *Column (5) / Column (4)*
6. *Sum of Lines 7 to 41.*