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: January 21, 2010

This decision adopts the Association of American Railroads' (AAR's) evidence for the calculation of average state tax rates for use in the Board's calculation of the 2008 revenue shortfall allocation method (RSAM).

BACKGROUND

In this proceeding, the Board revised its methodology to calculate RSAM, which is one of the three benchmarks used in the smallest rate cases under Simplified Standards for Rail Rate Cases, STB Docket No. 646 (Sub-No. 1) (STB served Sept. 5, 2007).[1] Specifically, RSAM was corrected to take into account state and federal taxes. By decision served November 21, 2008, the Board determined that it would account for taxes by calculating a tax-adjusted shortfall or overage, where the Adjusted $REV_{short/overage}$ = $REV_{short/overage}$ ÷ (1 - (State Tax Rate + (1 - State Tax Rate) × Federal Tax Rate)). Simplified Standards for Rail Rate Cases—Taxes in Revenue Shortfall Allocation Method, STB Ex Parte No. 646 (Sub-No. 2), slip op. at 5 (STB served Nov. 21, 2008) (November decision). Therefore, RSAM is now calculated as follows:

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

While federal tax rates are readily available, the Board also noted in the November decision that state tax rates should be incorporated through 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.

To obtain this information for 2002-2007, the Board directed the AAR to submit the evidence and calculations necessary to establish railroad-specific weighted average state tax rates for each Class I railroad, using the corporate income tax rate for each state in which a carrier operates and the number of miles operated in each state. Simplified Standards for Rail Rate Cases—Taxes in Revenue Shortfall Allocation Method, STB Ex Parte No. 646 (Sub-No. 2), slip op. at 2 (STB served Jan. 30, 2009). The AAR submitted this information on February 19, 2009

[1] Aff'd sub nom. CSX Transp., Inc. v. STB, 568 F.3d 236 (D.C. Cir. 2009), and vacated in part on other grounds on reh'g, CSX Transp., Inc. v. STB, No. 07-1369 et al. (D.C. Cir. Oct. 23, 2009).

(February 19, 2009 filing). In a decision served on May 11, 2009, the Board adopted the AAR's submissions, and noted that it would institute a separate proceeding to collect this information on an annual basis. Simplified Standards for Rail Rate Cases—Taxes in Revenue Shortfall Allocation Method, STB Ex Parte No. 646 (Sub-No. 2), slip op. at 6 (STB served May 11, 2009).

The Board instituted a separate rulemaking proceeding on September 21, 2009, to require the AAR to annually update the railroad-specific weighted average state tax rates for each Class I railroad. Annual Submission of Tax Information for Use in the Revenue Shortfall Allocation Method, STB Ex Parte No. 682 (STB served Sept. 21, 2009) (RSAM Notice). After that rulemaking proceeding was instituted, the Board noted in a decision in this proceeding that the RSAM Notice proceeding was expected to conclude prior to the point at which the state tax information would be needed for 2009, which would leave a gap in the Board's state tax information for 2008. Simplified Standards for Rail Rate Cases—Taxes in Revenue Shortfall Allocation Method, STB Ex Parte No. 646 (Sub-No. 2), slip op. at 1 (STB served Sept. 23, 2009) (September decision). Therefore, in the September decision, the Board directed the AAR to submit supplemental evidence and calculations necessary to establish railroad-specific average state tax rates for each Class I railroad for 2008, including the AAR's workpapers. Pursuant to the procedural schedule set forth in the September decision, the AAR submitted the requested information on October 23, 2009. No replies were received.

DISCUSSION AND CONCLUSIONS

The AAR submitted the 2008 state corporate income tax rates and the number of miles operated by each carrier in 2008 for each state in which it operated in 2008. The AAR determined the route miles operated in each state for each railroad by using column (g) of Schedule 702 of the Annual Report Form R-1 (R-1). As requested, the AAR submitted these figures for each Class I railroad for 2008.

With regard to the state tax rates, the AAR used the same method it used to submit the 2002-2007 tax information. The AAR began with the state corporate tax information published on the website of the Tax Foundation,[2] then the AAR and each Class I railroad reviewed those tax rates to ensure the accuracy of the information. The revisions made to the Tax Foundation's information are as follows:

1. Franchise Taxes—Connecticut, New Jersey, and New York impose franchise taxes that are not reported as income taxes, per the Generally Accepted Accounting Practices (GAAP), but are treated as franchise fees or similar items and reported as operating expenses (R-1 Schedule 410, Line 615). The AAR, therefore, changed the state income tax rates reported by the Tax Foundation to zero. This change is consistent with the modification made by the AAR in its February 19, 2009 filing.

2. Updated Data—Two states' tax rates were updated from what was reported by the Tax Foundation. Kansas lowered its surtax for 2008; the surtax is 3.1 percent,

[2] See http://www.taxfoundation.org/publications/show/230.html.

which makes the Kansas tax rate 4 percent plus 3.1 percent, or 7.1 percent. Michigan's rates also needed updating. As noted by the Tax Foundation, Michigan has begun a 4.95 percent income tax, but there is a 21.99 percent surcharge for 2008 that the Tax Foundation did not report. As a result, the tax rate equals 4.95 percent times 1.2199, or 6.038505 percent.

3. Rounding—For Arizona, the Tax Foundation rounded the tax to 7 percent, but the actual rate is 6.968 percent. The AAR used the actual rate.

4. Utility Franchise Tax—For railroads in Massachusetts, a utility franchise tax on income is paid in lieu of the corporate income tax rate, which is reported as an income tax in R-1. Therefore, the AAR reported the lower utility franchise tax as the rate for Massachusetts, rather than the corporate tax reported by the Tax Foundation. This change is consistent with the modification made by the AAR in its February 19, 2009 filing.

5. Ohio Taxes—Ohio is phasing out its corporate income tax and replacing it with a tax similar to the franchise fees discussed above. Therefore, beginning in 2005, the AAR reduced the corporate tax rate using the state's phase-out formula, which was 20 percent in 2008. The AAR did not compute the new tax because, like the franchise fees noted above, it is reported as an operating expense. This change is consistent with the modification made by the AAR in its February 19, 2009 filing.

6. Texas Taxes—For 2008, Texas taxed railroads using a 1 percent tax rate on 70 percent of gross receipts, which were reported as income taxes. Assuming the ratio of Operating Revenue to Net Income Before Taxes is the same in all locations where the railroad operates, the AAR calculated the 2008 tax rate by multiplying 70 percent of operating revenue from the R-1 (Schedule 210, Line 13) by the 1 percent tax rate, then dividing that number by Net Income Before Taxes from the R-1 (Schedule 210, Line 46). This change is consistent with the modification made by the AAR in its February 19, 2009 filing.

7. Water's Edge Election—In North Dakota, some corporations may be required to file their return using the worldwide unitary combined report method, in which case the company may elect to use a "water's edge" method and apply a 3.5 percent surtax. One railroad, Soo Line Railroad, elected to use the water's edge method, so its tax rate was adjusted to 10 percent, which is calculated by adding the 3.5 percent surtax to the 6.5 percent state tax rate.

Having made these changes to the state corporate tax rates reported by the Tax Foundation, the AAR calculated the weighted average state income tax rate for each Class I railroad for 2008.[3] The AAR's calculations and adjustments to the Tax Foundation's information were not contested by any party and, upon evaluation, appear reasonable. We will therefore adopt the AAR's evidence for the calculation of railroad-specific state tax rates to be

[3] AAR's October 23, 2009 Submission, V.S. of John T. Gray at 9.

included in the RSAM benchmark for 2008. The railroad-specific average state tax rates are set forth in the table below.

Average State Tax Rates

Railroad	**2008**
BNSF	5.668%
CNGT	7.593%
CSXT	5.746%
KCS	5.859%
NS	6.005%
SOO	8.634%
UP	6.051%

We will publish the annual determination of the RSAM benchmark in a separate decision.

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

It is ordered:

1. The AAR's evidence for the calculation of average state tax rates for use in the 2008 RSAM benchmark is adopted.

2. This decision is effective on its service date.

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