



Railway Association
of Canada

Association des chemins
de fer du Canada

Pre-budget 2016 Consultations

A submission by the Railway Association of Canada

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Table of Contents

1.0 Introduction.....	4
2.0 How the rail industry can support Canada’s economic’s objectives.....	4
3.0 Investments in rail can support multiple government objectives	4
Reduced emissions.....	4
Improved transportation safety	4
Improving the movement of people while leveraging the environmental benefits of rail	5
4.0 Our recommendations	5
Capital cost allowance.....	6
Shortline funding	7
Passenger rail funding.....	8
5.0 Closing	8



Acronym Table

CCA	Capital Cost Allowance
GHG	Greenhouse Gases
HFR	High Frequency Rail
ITA	Income Tax Act
RAC	Railway Association of Canada
TC	Transport Canada
U.S.	United States of America



1.0 Introduction

The Railway Association of Canada (RAC) welcomes the opportunity to participate in the 2016 pre-budget consultation.

2.0 How the rail industry can support Canada's economic's objectives

Railways are the lifeblood of the Canadian economy, allowing businesses to compete across North America and internationally. Railways move \$280 B of goods in Canada each year, which equals 50% of the goods destined for export and 70% of all intercity-freight traffic. Moreover, 75 M Canadians use passenger rail each year.

Railways invest record amounts into their infrastructure. Class 1 railways, namely CN and CP, invest 20% of their revenues per annum while the country's 50 plus shortline railways invest approximately 12%.

However railways compete directly against a subsidized trucking sector. Truckers have access to publicly funded infrastructure, while railways build, maintain, and expand their private infrastructure. This fundamental difference creates an unfair playing field for moving freight, and discourages Canadians from using passenger rail.

Furthermore, government investment in road infrastructure creates an everlasting need for public funding to maintain existing and build new road infrastructure.

3.0 Investments in rail can support multiple government objectives

Reduced emissions

Railways can support the government's objectives to reduce emissions by 30% below 2005 levels by 2030. With dedicated programs and strategies to manage greenhouse gas emissions (GHG), rail is a fuel efficient and emission-friendly mode of transportation¹.

Railways move one tonne of freight more than 200 kilometres on a litre of fuel. They produce five times fewer emissions than trucking, and a single freight train can replace several hundred trucks from the country's congested highway and road network.

While transportation-related GHGs hover around 30%, railways continue to improve their performance. Since 1990, railways have reduced their GHG intensity by more than a third, and despite moving substantive volumes of freight and passengers each year, they produce just 3% of Canada's transportation-related GHGs.

Improved transportation safety

Canada's railways are the safest railways in North America. Since 2005, the freight sector's accident rate has dropped by 41.4% and in 2014 the accident rate fell to 2.11 accidents per billion gross ton-miles - the second-lowest accident rate ever recorded.

¹ Since 1995, Canada's railways have maintained a series of Memorandum of Understanding with the Federal Minister of Transport to establish voluntary emission reduction requirements. Additional information is available at: <http://www.railcan.ca/publications/emissions>



However, since the terrible rail accident of July 6, 2013 in Lac-Mégantic, the rail safety regulatory environment has changed and new measures have come into play:

- The new *Grade Crossings Regulations* will require railways to invest more than \$350 M between 2015 and 2021, with an additional cost of approximately \$29 M each year, to meet new crossing standards dealing with signage, crossing surface specifications, system upgrades, etc. These requirements are not likely to be eligible for funding under the existing Grade Crossing Improvement Program.
- The *Railway Safety Management System Regulations, 2015* will impose significant administrative costs to federally regulated railways and to any railway operating over federal track. Some shortlines estimate that the regulatory requirements will cost between \$100,000 and \$200,000 per year.

Also, recent amendments to the *Transportation of Dangerous Goods Regulations* introduced specifications for a new class of tank car for flammable liquid dangerous goods service (to be built after October 2015), and require older tank cars to be phased-out over a detailed schedule. These cars are owned by shippers and leasing companies, and according to TC, the total costs of the regulations are estimated to be \$1,005 M over 20 years.²

The RAC believes that federal funding programs and competitive fiscal measures need to be in place to ensure that regulatory compliance costs are kept to a minimum and rail safety can continue to improve.

Improving the movement of people while leveraging the environmental benefits of rail

In 1977, the federal government created VIA Rail with the exclusive mission to organize and provide all intercity passenger train services in Canada — underscoring that passenger rail is an essential service.

At present, VIA Rail only owns two per cent of the tracks that it uses with the remainder owned by Canada's freight railways. Increased congestion on these tracks often leads to speed restrictions and the inability to schedule more trains — hurdles that prevent VIA Rail from fulfilling its mandate to Canadians. This situation is also far from ideal for the freight railways, as VIA occupies time slots during the day that impede freight movements.

VIA Rail has proposed a High-Frequency Rail (HFR) project that aims to develop a new dedicated passenger rail network between Montreal, Ottawa and Toronto. The HFR would be built using abandoned or available railway rights-of-way and would take approximately four years to complete.

4.0 Our recommendations

The following recommendations will allow the government to leverage the sector's ability to invest, and in doing so, realize objectives related to climate change, supporting small-to-medium sized business, and building sustainable infrastructure.

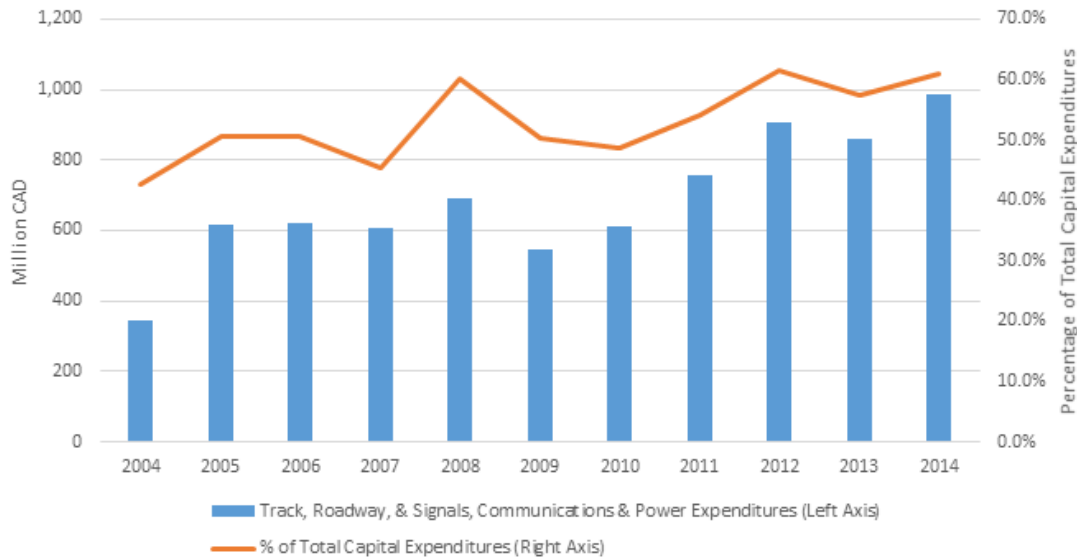
² Source: www.gazette.gc.ca/rp-pr/p2/2015/2015-05-20/html/sor-dors100-eng.php (see costs)



Capital cost allowance

Investment in infrastructure represents the largest component of annual spending for railways, with CN and CP investing nearly \$2 B in 2014 and 2015 on their tracks and signals. These investments reflect 55 to 60% of the railways' annual capital expenditures (Figure 1)³.

Figure 1: Class 1 freight railway capital expenditures for track and signals (2004 – 2014)



The railway track and property in question are captured under Class 1 of the *Income Tax Act* (ITA) regulations and are described in subsection 1101(5e.1). They include railway track and grading including components such as rails, ballast, ties and other track material; railway traffic control or signaling equipment; and a bridge, culvert, subway or tunnel that is ancillary to railway track and grading. These assets have a capital cost allowance (CCA) rate of 10% on a declining balance basis. Similarly, tank cars are captured in Class 7 and have a CCA rate of 15% on a declining balance basis.

Under the United States (U.S.) Modified Accelerated Cost Recovery System, the above-mentioned assets are completely depreciated at the end of year 8. This tax depreciation allows for approximately 69% of the asset cost to be written-off in the first 4 years, and the remainder in the last 4 years. Moreover, since 2001 the U.S. system has provided for a tax bonus depreciation ranging from 30% to 100% of annual rail infrastructure spending. This tax measure has been very successful in enticing U.S. railways to improve their network and their customer service. The bonus depreciation legislation was extended to 2019.

Changes to CCA and classes have been introduced to support economic policy initiatives. For example, the Government of Canada provided incentive for Manufacturing and Processing machinery and equipment by introducing new Class 53 (50% CCA, declining-basis) which allows for a faster write-off and cost recovery.

Recommendation 1

³ Source: Railway Association of Canada, 2016. Rail Trends Database.



The RAC recommends that in order to foster further contribution by the rail sector to the Canadian economy, and to soften the regulatory cost to railways and car owners in meeting new rail safety requirements as well as improve the Canadian CCA tax depreciation regime to become more competitive with the U.S. tax system, the Government of Canada should:

Introduce an accelerated capital cost allowance measure to encourage railways to invest in track and related property as defined under Class 1, in subsection 1101(5e.1) of the ITA regulations, and car owners (including shippers or leasing companies) to invest in tank cars as defined under Class 7 of these regulations. This measure would provide a 50% capital cost allowance rate for assets classified under Class 1 and acquired over a 7-year period starting effective in 2016 and ending in 2022, and over a 10 year period (2016 - 2026) for acquisitions under Class 7.

This measure will maintain and improve railway safety and support infrastructure spending to improve rail fluidity, economic prosperity and job growth.

Shortline funding

Shortlines are an integral part of the Canadian rail network, providing vital services to regional and remote communities. They operate on low density rail lines, feeding traffic to Class 1 railways, and providing shippers with a seamless rail link to the marketplace.

These smaller railways need to upgrade their infrastructure to capitalize on growth opportunities, while facing financial constraints. The 12 % of the revenue investment that shortlines make each year is mostly made to maintain current infrastructure and not upgrade or expand infrastructure. Infrastructure projects require both public and private sector funding.

To date the New Building Canada Plan and its predecessor have not been a significant source of funding to shortlines. Municipal and provincial public sector infrastructure projects are typically selected over shortline projects. Comparatively in the U.S., shortlines have access to a variety of funding programs at the Federal and State levels. These programs are innovative and include grants, low interest rate loans and tax credits.

Recommendation 2

The RAC recommends that in order to reduce the regulatory cost for shortline railways in meeting the federal government's objectives related to transportation safety, and to foster investment in infrastructure that generates multiple public benefits, the Government of Canada should:

Create a capital funding program of \$300 M over 7 years starting effective in 2016 and ending in 2022 which would be aimed at helping shortlines invest in their infrastructure.

The funds would be accessible through a refundable tax credit mechanism (limited to the lesser of 50 % of the eligible investment in the infrastructure or \$15,000 per mile of track of the network during the first two years, and to \$5,000 per mile for the following five years). This fixed funding amount per track mile would be similar to the existing U.S. program for shortlines, but would accelerate it for the first two years to foster shovel-ready projects.

Investments in shortline railways will also support the government's objectives to strengthen transportation safety as described in Section 3. Shifting traffic from road to rail will leverage private sector investment



into rail infrastructure, free up road capacity, reduce congestion and lead to lower road maintenance costs for governments and tax payers.

Passenger rail funding

A reliable, frequent, fast and cost-effective passenger intercity rail service requires a dedicated passenger network that would allow VIA Rail to run its trains at their full potential speed of 160 km/h, and to increase its ridership from 2 M to 7 M passengers a year. The expected financial returns would cover the project's costs, which are estimated to be approximately \$3 B.

VIA Rail's current fleet is over 40 years old making these aging assets increasingly expensive to maintain. The renewal of VIA Rail's rolling stock, presently estimated at \$1 B, would be a wise investment that would significantly reduce operating and maintenance expenses; increase passenger volume and revenues; and could be leveraged by the Crown Corporation to secure \$3 B of funding for its dedicated track project, from financial markets.

Recommendation 3

The RAC recommends that given the incredible potential of VIA Rail's dedicated inter-city passenger railway service proposal and noting that investments in passenger rail can support government objectives related to job creation, emission reduction, improving transportation safety, and optimizing Canada's railway network, the Government of Canada allocate \$1 B to VIA Rail's Quebec-Windsor Corridor fleet-renewal project, and in doing so, allow the railway to leverage this investment to secure an additional \$3 B from financial markets that can be invested in its shovel-ready and job-creating dedicated track project.

5.0 Closing

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