Working in Partnership to Improve Canada's Economic Prosperity and Competitiveness

The Railway Association of Canada

Submission to the House of Commons Standing Committee on Finance: Pre-Budget Consultations 2012

August 15, 2011

Executive Summary

The Railway Association of Canada (RAC) is pleased to have the opportunity to provide three primary recommendations and two secondary recommendations, which reflect views of its membership, regarding measures that the Government of Canada should take to improve the competitiveness of Canada's rail system and the economy as a whole. The submission concentrates on three recommendations as stated in the Executive Summary.

Primary Recommendations

Use of the Tax System to Promote the Utilization of New Technologies

Recommendation: The Federal Government should use the tax system to promote the utilization of new technologies including making changes, such as allowing refunding, to the SR&ED Tax Credit and allow tax credits for the deployment of new technologies.

Capital Cost Allowance (CCA) Rate for Rail Rolling Stock

Recommendation: Increase the Capital Cost Allowance rate for all rail rolling stock to at least 30%. This rate should be applicable to railway companies, rail leasing companies and private car owners.

Foreign/Free Trade Zones

Recommendation: The Federal Government should develop a new policy, supported by new programs, to establish competitive Foreign/Free Trade Zones in Canada.

Secondary Recommendations

Eliminate the Excise Tax on Locomotive Fuel

Recommendation: Eliminate the federal fuel excise tax on locomotive diesel fuel in order to reduce transportation costs for Canadian shippers, contribute to Canada's environmental goals, and match the U.S. which abolished its federal excise tax on locomotive fuel on January 1, 2007.

Further Strengthen and Facilitate Funding to Identified Trade Gateways and Corridors

Recommendation: In order to ensure Canada's rail system continues to be well positioned as a facilitator of international trade for North America, the federal government must further strengthen and accelerate funding for the development of rail and intermodal infrastructure within all identified trade gateways and corridors.

Introduction

The Railway Association of Canada (RAC) is pleased to have the opportunity to submit the views of its membership regarding measures that the Government of Canada must take to improve the competitiveness of Canada's rail system and the economy as a whole. Railways are an important part of the Canadian economy, as they move approximately 70 percent of total surface freight by volume to domestic, North American and international markets, employ more than 35,000 people, and pay more than $1 billion in federal and provincial taxes.

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The RAC represents some 50 freight, inter and intra city passenger railways - virtually all railways in Canada. The RAC is the one voice of Canadian railways.

Over the last 15 years Canada's railways have made significant progress in improving their productivity, which has been a key driver in improving Canada's economic competitiveness given the country's reliance on trade. Going forward, the industry needs to further adopt technologies due to the limitations of what can be achieved by physical and human capital alone. The three recommendations presented in the submission, if implemented, will assist the federal government's efforts in further enhancing Canada's global competitiveness.

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Use of the Tax System to Promote the Utilization of New Technologies

Recommendation: The federal government should use the tax system to promote the utilization of new technologies including making changes, such as allowing refunding, to the SR&ED Tax Credit and allow tax credits for the deployment of new technologies.

Canada's railway's have recognized that they way forward in terms of increasing productivity and capacity, improving safety, service reliability, and customer service, and reducing the environmental footprint is the development and deployment of technology. Although certain technologies have been tested, implemented and proven, others are still in the pre-commercial stage and need additional development and testing. The rail industry is only beginning to know the art of the possible given the exponential and explosive nature of new technology and its practically limitless application. The direct challenge is related to the cost of developing, testing and adopting technology in operating conditions. The government has a significant role to play in supporting R&D around technology developments and also facilitating the process between research, commercialization and deployment of technologies.

New technologies will require significant investment in communications to network trackside assets and IT back office systems to house and analyze significant amount of data. The ability of the railways to handle significantly increased volumes in the future will require major investment in infrastructure within key corridors. The capital requirements to make such changes will be significant. Given the broader economic benefits that will be realized through such investments, the federal government should implement additional incentives, such as tax credits and capital cost allowances, to promote capital spending on new technologies.

Currently, railways have direct experience with the SR&ED tax credit program. In general terms, the experience with the administration of the program has been positive. A primary issue that would improve the federal program would be to make the tax credits refundable for all corporations, not just small business. For example, the Government of Alberta offers a refundable SR&ED tax credit for larger companies. This will enable funding earlier when it is need as opposed to years in the future. The SR&ED program could also be expanded beyond research and development to allow the tax credits for the deployment of new technologies.

Capital Cost Allowance (CCA) Rate for Rail Rolling Stock

Recommendation: Increase the Capital Cost Allowance rate for all rail rolling stock to at least 30%. This rate should be applicable to railway companies, rail leasing companies and private car owners.

The railway industry is highly capital intensive. Canadian railways are required to invest approximately $2.5 billion on an annual basis in order to maintain their infrastructure and ensure that they can move their goods in a safe and cost effective manner.

In Budget 2008, the Government announced an increase in the Capital Cost Allowance (CCA) Rate for rail locomotives from 15 to 30 per cent. This announcement was welcomed by Canada's railway industry and is already paying dividends for railway companies, locomotive manufacturers, the rail supply sector, and the Canadian transportation system.

The RAC fully supports the Standing Committee on Finance's 2007 Report calling for the Government to fully implement the tax measures contained within the Industry Committee's unanimous 2007 report entitled *Manufacturing: Moving Forward – Riding to the Challenge*. A specific tax measure in this report recommends that the "Government of Canada raise the capital cost allowance rate for rolling stock, locomotives, and inter-modal equipment to 30% using the declining balance depreciation method."

The current CCA rate for rail rolling stock beyond locomotives is 15 per cent and does not reflect their useful economic life. Railway companies are constantly improving rail cars in order to keep pace with customer demand. Under the current rate, it takes a rail company 20 years to fully depreciate rail cars, many of which have undergone significant improvements if not total replacement well before that time.

The depreciation rate for all rail rolling stock in the U.S. is approximately 30 per cent, using their philosophy of combining both decline and straight line balances. As such, U.S. railroads can fully depreciate their rail rolling stock in 8 years versus 20 years for Canadian railways. This puts Canadian railways at a competitive disadvantage as compared to their U.S. competitors. The U.S. tax code facilitates faster asset renewal thereby enabling the entry into service of newer rail cars which reflect the growing demands of rail customers.

Foreign/Free Trade Zones

Recommendation: The Federal Government should develop a new policy, supported by new programs, to establish competitive Foreign/Free Trade Zones (FTZs) in Canada.

As of the beginning of 2007, there were more than 2,700 Free Trade Zones (FTZs) around the world, providing employment for more than 63 million people.[1] In general, normal trade barriers such as tariffs and quotas are eliminated in FTZs and bureaucratic requirements are lowered to attract new business and foreign investment. Companies operating within a FTZ may also be granted certain host country income tax breaks or holidays as an additional incentive. These zones are often located at or near a port of entry to facilitate import and export activities. The common expected economic benefits that may be associated with FTZs are foreign exchange earnings, employment creation and income generation, attraction of foreign direct investment, and technology transfer and knowledge spill-over.[2]

The RAC recognizes that the federal government took measures in the 2009 Federal Budget Plan to provide tariff relief on a broad range of machinery and equipment and took additional measures in the 2010 Federal Budget Plan to eliminate all remaining tariffs on manufacturing inputs, machinery and equipment. Further, the Government of Canada currently has programs

[1] www.ilo.org, September 15, 2008
[2] Deloitte, Free Trade Zone Study, October 2008, pg 3&4.

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such as Duty Deferral Program, the Export Distribution Centre Program, and Exporters of Processing Services Program, that are intended to provide similar incentives as those in FTZs. However, the limitations associated with the programs, as compared to true FTZs, have resulted in lower than anticipated participation by business. In addition, the programs are operated by different government agencies (Canada Border and Services Agency and Canada Revenue Agency) which increase the regulatory complexity for businesses that wish to participate in more than one program.

However, a new approach is required as the existing programs do not meet the needs of firms, as evidenced by lack or participation, engaged in global trade. The establishment of competitive FTZs will further improve Canada's economic standing, attract additional foreign capital and create employment.

Secondary Recommendations

Excise Tax on Locomotive Fuel

Recommendation: Eliminate the federal fuel excise tax on locomotive diesel fuel in order to reduce transportation costs for Canadian shippers, contribute to Canada's environmental goals, and match the U.S. which abolished its federal excise tax on locomotive fuel on January 1, 2007.

The federal government applies a $0.04/litre excise tax on locomotive diesel fuel. Currently, railways pay approximately $75 million annually in federal fuel excise taxes and are primarily passed onto shippers through freight rates or tariffs. Currently, fuel taxes represent a tax burden of 2.4% of revenue for Canadian railways as compared to 0.91% for their U.S. competitors.[3]

Railways own and maintain their right-of-way and invest approximately $2.5 billion annually into their capital stock and infrastructure. Unlike trucks, railways do not use publicly funded infrastructure. As such, an elimination of the locomotive fuel excise tax would increase the competitiveness of Canadian railways and shippers.

Canada's railways compete directly in the North American transportation market. With direct access to the vast North American consumer market, global trade patterns and the increasing importance of transportation logistics provide significant opportunities for Canada. For example, containers arriving from Asia destined for the North American market may be moved by both U.S. and Canadian railways en route to their final destination. In order to take advantage of these opportunities, Canada's railways require a competitive domestic regulatory and taxation system compared to their U.S. competitors.

On January 1, 2007 the U.S. abolished its federal excise tax on locomotive fuel. This measure has clearly established a competitive advantage for U.S. railways versus their Canadian competitors. Rail shippers are extremely price sensitive, meaning that even a slight price advantage in one jurisdiction over another will effectively shift traffic away from higher cost jurisdictions. The additional cost borne by Canadian railways works to makes rail transportation less attractive to rail shippers and puts Canada in an uncompetitive position regarding the movement of North American freight.

Further Strengthen and Accelerate Funding to Identified Trade Gateways and Corridors

[3] PricewaterhouseCoopers, "The Tax Burden of Canadian Railways", March 2011.

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Recommendation: In order to ensure Canada's rail system continues to be well positioned as a facilitator of international trade for North America, the federal government must further strengthen and accelerate funding for the development of rail and intermodal infrastructure within all identified trade gateways and corridors.

The RAC commends the federal government for committing $1 billion to the Asia-Pacific Gateway and Trade Corridor Initiative and $2.1 billion to fund projects and border crossings within the Ontario-Québec Continental Gateway and Trade Corridor and the Atlantic Gateway, for the period 2007/08 to 2013/14. These funds, if allocated strategically and in a timely manner will improve the competitiveness of our rail and intermodal transportation system.

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However, the allocation of these funds to rail and intermodal infrastructure to date has been far too slow. After more than four years since the budget allocation to the Ontario-Québec Continental Gateway and Trade Corridor and the Atlantic Gateway there have been limited funds available for rail infrastructure.

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Canadian railways are in direct competition with U.S. railways for North American bound traffic. Currently, more than 40 per cent of freight moving through the Ports of Montreal and Halifax are destined to the U.S. market. Further, virtually all the intermodal traffic arriving at the Port of Prince Rupert is moved by rail to the U.S. In order for our ports to continue to attract and grow their share of North American bound freight, governments must make the necessary strategic investments to facilitate the movement of goods within the North American market. Railways are well positioned to move goods over long distances in an environmentally sustainable manner as they are 3-5 times more fuel efficient than trucks.

Rail has proven to be an important partner in the development of the Asia-Pacific Gateway and Trade Corridor, partnering with governments in over $285 million in road/rail grade separations and improving rail infrastructure at the Port of Metro Vancouver, Roberts Banks and the Port of Prince Rupert. However, further investments are required to fully realize the potential of our port and rail system. Additional investments will allow our railways to improve their productivity, which in turn will benefit the ports and shippers who rely on rail service to get their products to market.

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