

On the Wrong Track

Railroads in New York State have left the 19th Century far behind. It's time our system for taxing them did, too.

Railroads played a key role in New York State's development as an industrial powerhouse. Manufacturing centers, particularly those areas where water transport was not available, relied on the railroads to deliver raw materials and fuel to help produce finished goods—and to take those goods to the marketplace. Wherever the rails ran, good jobs were sure to be found.

Today, thousands of industrial jobs across the state still depend on rail freight. Unfortunately, the rails don't run nearly as far today as they did even a decade or two ago. A long history of overassessment by local

Railroads' unusually high property tax burden in New York discourages investment.

officials, and the state laws that govern local property taxes on railroads, strongly discourage investment in rail lines in the Empire State.

Rail taxes in New York are more than seven times as high as those in Massachusetts, and 26 times as high as New Jersey's, on the basis of tax paid for each mile of track.

A recent survey by the state Transportation Department found the need for \$1.2 billion in capital investment to make New York's railroads as modern and efficient as possible. State funding may provide some of those dollars, but most will have to come from private-sector investment. Such investment is likely to be limited as long as the current tax regime remains in place.

That's one reason total trackage in New York has

INSIDE

Rail freight is as important to key sectors of New York's economy today as it was in past decades. But we've been losing rail mileage—and railroad jobs.

◆ **New York's property tax burden on railroads far exceeds the comparative cost in neighboring states.**

◆ **That, in turn, discourages investment in new and upgraded lines—and it puts some existing lines in constant jeopardy.**

◆ **The problem traces to a long history of overassessment of rail property by local officials in New York.**

◆ **Those overassessments are backed up by an arcane and outdated set of state laws.**

◆ **And besides jeopardizing rail service and railroad jobs, those high property taxes drive up costs for manufacturers, electric power consumers, and often the local governments themselves.**

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been cut by half – and the state has lost more than 11,000 railroad jobs – in the last two decades.

New York can get back on the right track, however, if it reduces the tax burden on railroads and brings the rail property tax into the modern era.

A key industry, a discriminatory tax

Promoting and preserving rail-based freight and passenger traffic has been official New York State policy for half a century – and with good reason. Most of the crown jewels of the state’s important manufacturing sector depend on rail. So do employers in other key industries, from agriculture to logging to salt production.

These businesses, employing hundreds of thousands of New Yorkers, ship freight by rail because it’s cost-effective and energy-efficient. One double-stack intermodal train can move the equivalent of 280 truckloads; modern railroads can move a ton of freight an average of 389 miles per gallon of diesel fuel used. Because of these and other advantages, state government has invested tens of millions of dollars in promoting the rails as a key part of our overall transportation infrastructure.

But, while the state promotes railroads with some policies, it maintains a discriminatory, anti-competitive property tax system that drives up costs for railroads as well as their customers.

Most businesses and homeowners in New York State pay property tax based on the perceived market value of their property. Taxpayers often dispute the value estimated by a local taxing jurisdiction, but the basic structure of the property tax makes sense.

Not so with property taxes on railroads.

As long ago as World War I, railroads in New York and some other states were taxed more heavily than other business, residential and agricultural property. Local tax assessors tended to see rail property, usually owned by a corporation headquartered in a distant city, as a cash cow to be milked as much as possible. Development of the trucking industry, which relied on roads built with taxpayer dollars, cut into railroad traffic and profits available for new investment. During the 20th century, most states adapted their tax systems to reflect the reality of the rail industry as one involved in intense competition with trucking, air and water transport. That modernization never took place in New York.

The state’s decades-old process for assessing railroad property for tax purposes includes two steps that drive assessments, and therefore property taxes, to a level that is wildly out of sync with market realities. Municipal tax assessors start estimating the value of railroad land – track rights-of-way as well as stations, switching yards and other properties – on the basis of “across-the-fence” value. In other words, the assessed value of the rail property is based on the market value of adjacent property, adjusted for lot size and other factors. This initial valuation almost always inflates the assessment. Most railroad property consists of narrow strips where rail lines pass between residential or agricultural land. Even if the

Railroads and New York's Economy: Just the Facts, 2000

<i>Tons of freight terminated</i>		<i>Tons of freight originated</i>	
Coal	9,548,146	Waste & scrap material	2,276,940
Food products	2,619,532	Chemicals	1,985,916
Chemicals	2,197,108	Transportation equipment	930,215
Farm products	2,141,931	Food products	727,576
Pulp & paper products	1,673,300	Petroleum	691,916
All other	7,290,902	All other	3,248,311
Total	25,470,919	Total	9,860,874
<i>Miles operated, excluding trackage rights</i>	3,683	<i>Carloads of freight</i>	1,781,620

Source: Association of American Railroads

neighboring owner were interested in acquiring such property, the market price would, in most cases, be a fraction of the price per acre of neighboring land.

New York's rail property assessment law imposes a second valuation method that artificially inflates property values. Structures, track and other improvements on land are valued based on "reproduction" costs—a method used in no other state. Reproduction cost refers to the cost needed to re-build each improvement, if it were to be removed or destroyed in a fire or other disaster, as when it was new. Most states use, instead, "replacement" cost—what it would take to replace lost buildings or other assets with today's technology. Because construction methods become more cost-efficient over time, use of the reproduction cost method artificially raises the assessment—particularly for infrastructure that is several decades old, as is often the case in the railroad industry.

As a result of the financial troubles in the rail industry extending back half a century, state law caps each railroad's property taxes based on the company's operating profits or losses. But that provision simply means when a railroad has a good year, its property taxes rise sharply, making it difficult to invest profits back in the system.

A 'uniquely damaging' tax

While the structure of New York's railroad property tax is complicated, its effects are simple to describe. In a 1995 analysis, Dick Netzer, professor of economics and public administration at New York University and one of the nation's leading academic experts on property taxes, concluded: "The New York system of railroad *ad valorem* taxation can be uniquely damaging to carriers and to the state's economy." Netzer found that "excessive taxation" in New York "must act as a deterrent to investing in real property assets that will increase tax liabilities over time."

Indeed, railroads that operate in New York as well as in other states pay far higher property taxes, relative to the extent of their property, in the Empire State.

Heavy taxes on railroads create another uncompetitive cost of doing business for New York's manufacturers.

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For instance, in 2001, CSX paid \$10,523 in property tax per mile of track in New York. That was 17 times the company's average of \$609 per mile in the neighboring states of Pennsylvania, Massachusetts, Connecticut and New Jersey. (The per-mile cost in New York was nearly eight times that in Massachusetts and 26 times the cost in New Jersey; Connecticut does not impose a property tax on rail mainlines.) New York track represents 7 percent of the entire CSX system, but property taxes in the state are 31 percent of its systemwide total—a ratio of more than 4 to 1 that has actually worsened in recent years. The CP Rail System pays \$4,857 in property taxes per mile of rail in New York, compared to \$570 in Pennsylvania.

While CSX, Norfolk Southern and Canadian Pacific Railway are the largest railroads serving the state, some two dozen regional and local railroads are also important because they link manufacturing and other businesses to the mainline rails. Examples include the New York, Susquehanna & Western, with lines connecting Utica and Syracuse to Binghamton and other points; and the Livonia, Avon & Lakeville Railroad Corp., which operates over 68 miles of track in the Finger Lakes and Southern Tier regions.

Some of this higher cost is, inevitably, passed on to freight shippers. It constitutes another uncompetitive cost of doing business for New York manufacturers. And the high cost of rail taxes shows up in unexpected places—for instance, the millions of dollars that municipalities across the state spend each year on road salt. Coal, another freight commonly shipped by rail, is an important part of the state's fuel mix for generation of electricity—which, in turn, is another area where high railroad taxes raise costs.

Losing rail, losing jobs

Logic says that when rail taxes are already high, and improving railroad property would drive them still higher, railroads will be loath to invest in new track and other improvements. That's precisely what has happened in New York. Indeed, New York's property tax system gives railroads an equally strong incentive to *disinvest* in the state—and that's happened, too. In the last 20 years alone, major railroads in the state have cut total track mileage by half, from around 4,000 miles to around 1,900. Industry employment in the state fell even more sharply, from above 17,000 in 1981 to just over 6,000 at the end of 2001. Freight railway jobs are among the best-compensated in the marketplace, with wages and fringe benefits averaging more than \$71,000 in 2000, according to the Association of American Railroads.

As railroads removed unused track to ease the burden of high property taxes, industrial development along the freight lines formerly operated by Conrail declined. From 1996 to 1998, 36 new or expanded industrial locations opened along Conrail tracks in New York, compared to more than 100 during a similar period a decade earlier, according to CSX Transportation, which now operates much of the old Conrail network. At the same time state leaders were cutting taxes, identifying preferred sites for large manufacturing and other employers who could create hundreds of jobs at once, and taking other positive steps, New York continued to lose key pieces of infrastructure that might have attracted new businesses in the future.

Tax considerations are among the reasons that, for instance, the drawbridge over the Buffalo River in Western New York has not been rebuilt or expanded. Without such work, the bridge remains a bottleneck that hampers the growth of shipping traffic between New York and points west, including Canada. At the other end of the state, expanding rail freight into and from New York City is widely considered a key step toward retaining manufacturing jobs. While most U.S. urban areas move one-third or so of their freight by rail, in New York City the proportion is only about 3 percent. Given such substantial room for growth, it is quite possible that greater use of rail freight in the metropolitan area would reduce vehicle emissions sharply, making it easier to comply with increasingly strict provisions of the federal Clean Air Act.

The tracks and other taxable property at issue belong to companies whose business is running freight trains. Passenger trains run on many of those same tracks, ideally at higher speeds than freight trains. If freight railroads upgrade their tracks to handle speeds that Amtrak needs, but their freight trains don't, their taxes go up. So in effect, current law penalizes freight railroads for cooperating with state government's efforts to improve passenger service. The Empire State Passenger Association, representing Amtrak users, calls railroad tax reform a "vital issue." The state has spent millions of dollars to promote high-speed passenger services, but improvements have been slow in coming because of speed limitations made necessary by track considerations. If and when the property tax issue is resolved, faster Amtrak service both along the Hudson River and west of Albany will be a major step closer to reality.

Getting back on the right track

Because only a relative few municipalities around the state – most in Western New York and the Southern Tier – receive a significant proportion of their revenue from rail property, one way to make New York's rail taxes more competitive would be for the state to provide transitional aid to those localities for a few years. Legislation to do so has been considered several times in recent years, but has not become law.

A 1976 federal law prohibits discriminatory taxes on railroads compared to other businesses. More than 700 school districts and municipalities statewide recognized that current assessments violate the law in a 1997 settlement with Conrail, then the primary freight railroad in the state (CSX and Norfolk Southern began operating most Conrail lines in 1999). The settlement covered property taxes in 1993 through 2000, with the expectation that state tax reform would resolve the issue in later years. With no action so far, railroads are again pressing the case in court, but that solution could take years.

But why should New York State wait for a court-ordered solution to the problem of high railroad taxes? Efficient, competitive rail service can preserve thousands of good jobs in the railroad industry – and help stop the loss of good manufacturing jobs the state has experienced for decades. Important as part of our history, and critically important to our economic future, railroads will not thrive in the Empire State if they must continue paying anti-competitive property taxes. It's long past time for a new, fairer approach.

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A Special Report:

On the wrong track: rail taxes in New York

