Railway Association of Canada
Association des chemins de fer du Canada

Submission to the Standing Committee on Finance

Pre-budget 2019 Submission

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99 Bank Street, Suite 901, Ottawa, ON Canada K1P 6B9
T 613.567.8591 **F** 613.567.6726 **E** rac@railcan.ca www.railcan.ca

Pre-budget 2019 Submission

The Railway Association of Canada (RAC) welcomes the opportunity to participate in the 2019 pre-budget consultation[1].

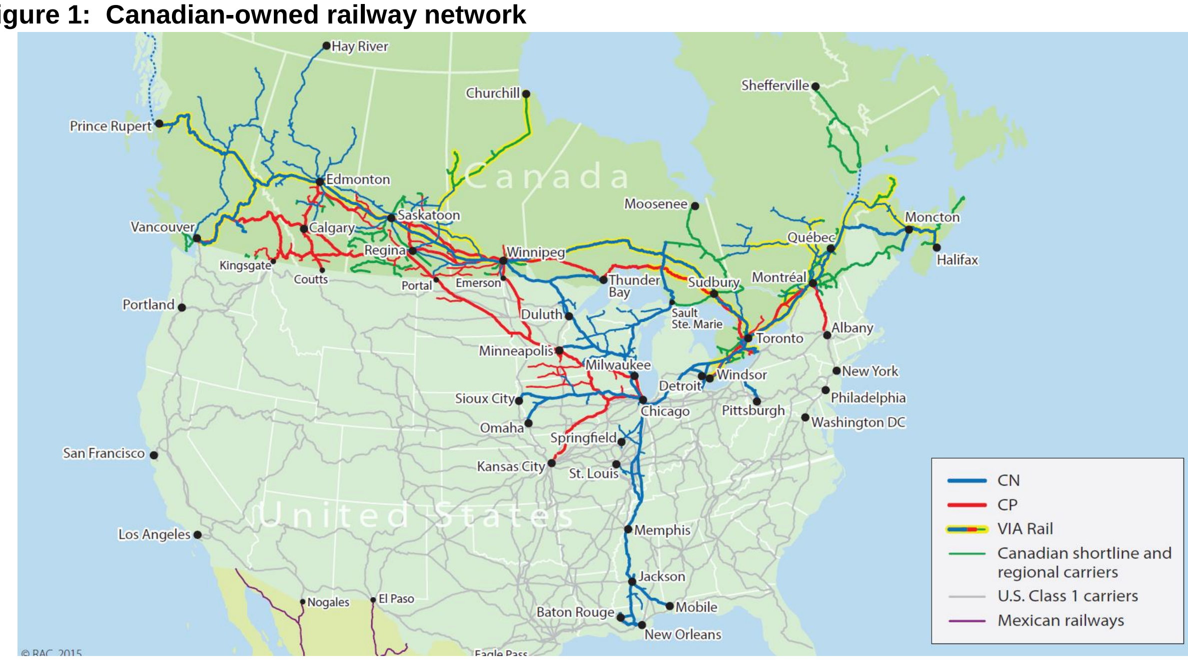
Canadian-owned railways enable competitiveness and support trade by transporting approximately $280 billion of Canadian-originated goods each year[2]. This traffic reflects 50 per cent of the country's goods destined for export (by volume) and 70 per cent of intercity freight traffic[3]. In addition to freight traffic, nearly 85 million people use railways to travel to and from work or for leisure, reducing emissions and congestion, and wear and tear on Canada's busiest roads and highways.

As critical components of the economy, railways provide a low-cost, safe and emission friendly service to their customers.

The Canadian Railway Franchise

Canadian railways provide service to more than 10,000 customers by using finite resources, including track infrastructure, right of ways, yards, locomotives, and crews. This network consists of two Canadian-owned and operated Class I railways and more than 50 local and regional railways.

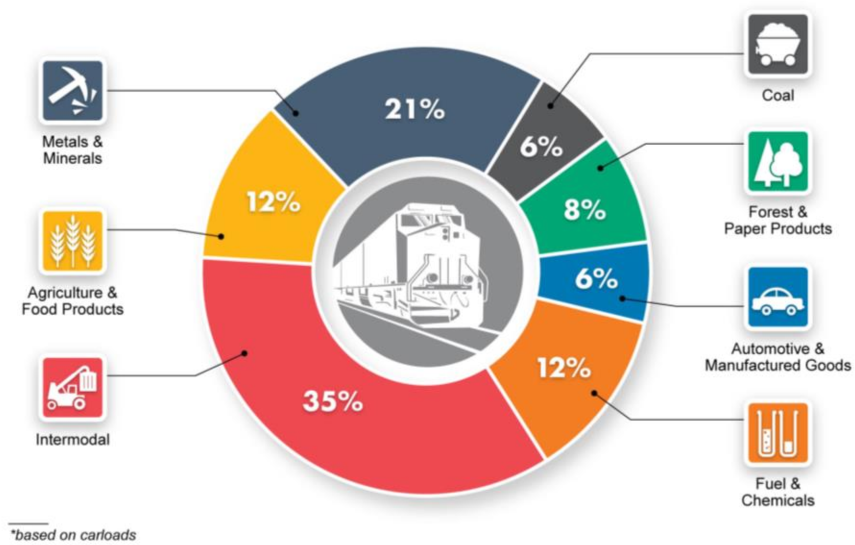
Figure 1: Canadian-owned railway network



[1] Additional information about the Railway Association of Canada can be found at: www.railcan.ca
[2] Source: Railway Association of Canada. Internal calculations using various sources, 2018.
[3] Ibid.

Freight railways drive the Canadian economy by moving a diverse suite of goods, including: bulk commodities such as grain, potash and lumber; container traffic including retail and wholesale goods; and dangerous goods such as chlorine and sulphur. Nearly 5 million carloads of freight are moved by approximately 2,300 locomotives and 31,000 dedicated railroaders across 44,000 kilometers of track that spans nine provinces, one territory and several points throughout the United States (U.S).[4]

Figure 2: Railway traffic mix (2016)



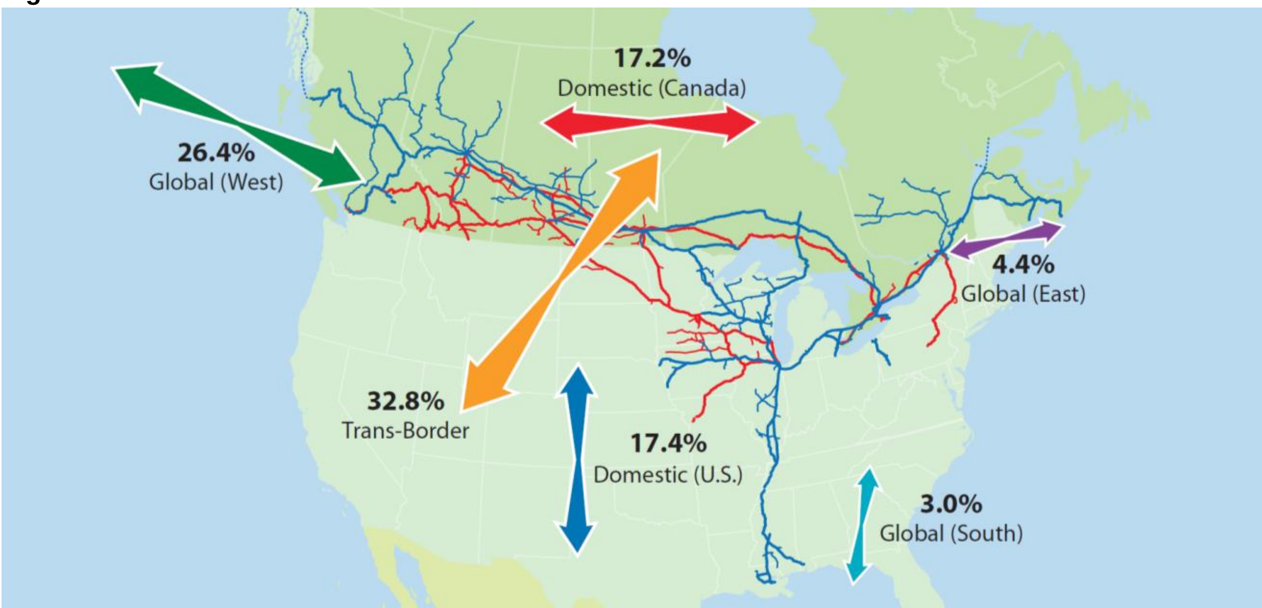
Rail also provides many environmental benefits that position it as a critical partner in the Government's efforts to reduce emissions. Freight rail is four times more efficient than truck, while passenger rail is three times more efficient than the average car. Furthermore, a single freight train can remove more than 300 trucks from Canada's road and highway network[5].

In 2015, more than 65 per cent of all railway revenues were attributed to trade-related traffic, of which the majority flows between Canada and the U.S. (Figure 3). In terms of tonnage, approximately 75 per cent of Canadian originated traffic is exported to the U.S. and to other international destinations. **Figure 3** provides an overview of the markets that railways enabled for their customers in 2015 (as measured by the percentage of railway revenues and their respective destination, including imports and exports), highlighting that a resilient railway network is a prerequisite for international trade.

[4] Statistics extracted from Rail Trends 2017. Available at: https://www.railcan.ca/wp-content/uploads/2018/01/Rail_Trends_2017.pdf

[5] Additional information about the environmental benefits of rail is available at: https://www.railcan.ca/wp-content/uploads/2017/06/ClimateChange_infographic_2018_EN.pdf

Figure 3: Market reach



Improved movement of people through passenger rail

Early this year VIA took a substantive step forward in its efforts to ensure that Canadians benefit from travelling in a passenger rail fleet that is efficient, safe, accessible and affordable. Budget 2018 provided funds to replace VIA's aging fleet in the Quebec City-Windsor Corridor, which serves over 90 per cent of its passengers, and included $8 million for Transport Canada to undertake more work to advance VIA's proposed high frequency rail (HFR) project.

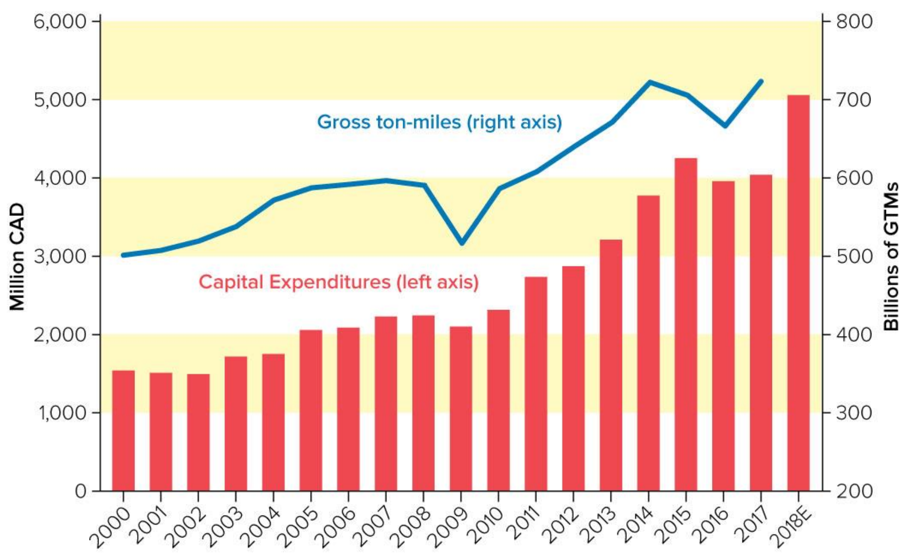
The HFR plan will allow VIA to better connect Canadians in the most populous region of the country by increasing train frequencies, shortening trip times, and providing more reliable service. This initiative will enable Canadians to be more productive while helping the Government achieve its emissions reduction goals, by reducing 10 (megatonnes) Mt (or 14 Mt if electric) of CO_2 emissions over 30 years, which is equivalent to removing 10 per cent of cars from the road for one year in Canada[6]. This plan is endorsed by the RAC as well as several communities in Ontario and Quebec[7].

[6] For additional information about VIA Rail's HFR proposal, please visit: http://www.viarail.ca/en/about-via-rail/governance-and-reports/dedicated-tracks
[7] For additional information see: https://slchamber.ca/2017/07/26/local-chambers-support-high-frequency-rail-continues-gain-traction/ http://www.lapresse.ca/le-nouvelliste/actualites/201706/19/01-5108954-trois-rivieres-et-drummondville-embarquent-dans-le-meme-train.php http://www.eowc.org/en/news-ongoing-projects/resources/MINUTES-August-13-2017-EOWC.pdf

<u>Investments drive performance</u>

A competitive and commercial-focused regulatory framework is a prerequisite for driving productivity and the levels of investment that are required to ensure that railways can continue to drive economic development and support trade. In 2017, Canadian Class 1 railways invested more than $4 billion (approximately 21 per cent of their revenues) in their continental networks[8]. Since 1999, railway investments in Canada alone have exceeded $25.9 billion and have allowed our members to grow their volumes in line with the Canadian economy (**Figure 4**)[9]. These investments are critical to maintaining the safety, velocity, capacity and service of the network.

Figure 4: Class I railway capital expenditures



While Canadian Class I railways invest substantive amounts of capital back into their networks each year, shortline railways are not able to match similar levels of investment. Shortline railway investments are generally constrained by their limited ability to borrow against their capital and a revenue stream that is compromised by their principal competitor – a subsidized trucking sector. Yet these railways face significant headwinds because of increased costs associated with new federal grade crossing regulations, insurance premiums for dangerous goods and carbon pricing. On average, shortline railways invest only 10 per cent of their revenues back into their capital each year.

[8] CN and CP 2017 Annual Reports.
[9] CN and CP 1999 to 2017 Annual Reports.

Recommendations

RAC maintains the position that the Government of Canada should provide a legislative and policy environment that can unlock the levels of investment today that are required to capitalize on the economic and trade opportunities of tomorrow. Our recommendations aim to encourage competitiveness by addressing several barriers to investment in Canada:

Amendments to Tax Rates and Bonus Depreciation

The recent adoption of sweeping tax measures in the U.S. causes our members concern. Coming into force on December 22, 2017, the *Tax Cuts and Jobs Act* reduces the federal statutory corporate tax rate for U.S. companies from 35 to 21 per cent. Furthermore, the new Base Erosion and Anti-Abuse (BEAT) minimum tax will increase costs for Canadian railways. This provision will force a U.S. entity to pay the BEAT on payments made to its Canadian parent company, while not allowing the parent company to claim an offsetting credit or deduction for the equivalent amount of BEAT paid in the U.S.

The legislation also provides 100 per cent depreciation for new and used property/capital acquired after September 27, 2017 and before January 1, 2023. They exclude property/capital used by a regulated public utility and certain real property used in a real property trade or business. Effectively, the U.S. has moved from a 50 per cent bonus depreciation in the year of acquisition to 100 per cent, which we deem to be significant. By comparison the existing depreciation rate in Canada for railway track and property is 10 per cent on a declining balance basis[10].

We are also concerned with the impact that these measures will have on the marginal effective tax rate (METR) on new business investment. The tax reform bill will drop the U.S. METR from 34.6 per cent to just 18.8 per cent, while Canada's METR hovers at 20.9 per cent[11]. The potential net effect of this substantive change means that the effective tax rate in the U.S. will be below Canada's in most sectors, including transportation. Historically Canada's METR has been lower than the U.S. METR.

The tax reform bill has altered the competitive landscape in North America and underscores that tax change in Canada is required to ensure that railways remain competitive and can continue to invest at a rate that is comparable to previous years and proportionate to their American counterparts.

Considering these amendments, RAC recommends that the Government of Canada:

1. aligns the METR for Canadian companies with the METR in the U.S.;
2. allows railway companies to deduct the full amount of capital expenditures immediately; and

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[10] Railway track and property is 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.

[11] Philip Bazel, Jack Mintz and Austin Thompson (2018). Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3136437

3. ensures that there is no double taxation on intercompany transactions by creating a corresponding offset in Canada for the new BEAT minimum tax in the U.S.[12]

Investments to Shortline Railways

To date neither the New Building Canada Plan (and its predecessor) nor the National Trade Corridor Fund have been a significant source of funding for shortlines. Comparatively U.S. shortlines have access to a variety of innovative federal funding programs that include grants, low interest loans and tax credits. RAC recommends that the Government of Canada:

4. create a capital funding program of $365 million over 6 years (effective in 2019 and ending in 2024) that will support shortline infrastructure investment and reduce the costs associated with new rail safety requirements.

   The funds would be accessible through a mechanism, which would limit contributions to the lesser of 50 per cent 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 remaining five years.

   This fixed funding amount per track mile would be similar to the existing U.S. program for shortlines but would be accelerated in the first two years to foster shovel-ready projects.

RAC strongly encourages the Government of Canada to support the Huron Central Railway (HCR). This railway provides a critical rail service to customers from Sault Ste. Marie to Sudbury and requires immediate support to continue operations beyond 2018[13]. The railway forecasts that a federal-provincial contribution of $42 million is required over a five-year period to maintain the line in operation. In addition, HCR is committed to investing more than $4.6 million in the railway. RAC recommends that:

5. Budget 2019 leverages private sector investment and includes a federal contribution to maintain HCR operations beyond 2018.

Investments to VIA Rail

The Government of Canada's commitment to finance the purchase of new trains to replace VIA's aging rolling stock is a significant next step in the evolution of Canada's inter-city passenger rail service. This renewal is also important as it can be leveraged to secure funding from financial markets, as well the Infrastructure Bank of Canada, for VIA's proposed High Frequency Rail project.

[12] Implementation of this recommendation would ensure that domestic tax rules align with the tax treaty between both countries so that intercompany transactions under transfer pricing rules receive a fair match so that what is taxable in the country of the recipient is deductible in the country of the payor.

[13] Additional information available at: https://www.newswire.ca/news-releases/huron-central-railway-to-discontinue-operations-by-year-end-683336021.html

The implementation of a dedicated track network, with trains that run at their full potential of 160km/h, would enable VIA to provide a fast, frequent, reliable, and cost-effective intercity rail service to Canadians, increasing ridership from 4.1 million today to 9.9 million passengers in 2030. This shovel ready project, estimated at $4 billion, could be completed in four construction seasons. The project would fulfill several government-objectives including economic growth, job creation, sustainable infrastructure, greening of federal operations, and safe transportation. It would eliminate VIA's Corridor operating subsidy by 2024.

RAC recommends that the Government of Canada:

6. empowers VIA Rail to leverage investment in fleet renewal to allow it to secure an additional $4 billion from financial markets for the HFR project;
7. ensures that government investments into passenger rail (including intercity and commuter rail) are coordinated so that rail services are interoperable and interconnected; and
8. ensure that intercity rail can work inter-operably with other services to continue to provide downtown to downtown service for passengers.

Closing

The RAC would welcome an opportunity to appear as a witness when the Committee resumes in the fall. In the interim, questions or comments can be directed to Michael Gullo, Director, Policy at 613-564-8103 or mgullo@railcan.ca.