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# SENATE COMMITTEE ON REVENUE AND TAXATION

Senator Jerry McNerney, Chair

2025 - 2026 Regular

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**Bill No:** SB 1287  
**Author:** Hurtado  
**Version:** 2/20/26  
**Consultant:** Summers

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**Tax Levy:** Yes  
**Fiscal:** Yes

***PERSONAL INCOME TAX LAW: CORPORATION TAX LAW: CREDITS: SHORTLINE  
RAILROAD EXPENDITURES AND RAILROAD INFRASTRUCTURE***

*Authorizes credits against the Personal Income and Corporate Taxes for Class II or III shortline railroads in an amount equal to 50% of the qualified shortline railroad expenditures and 50% of the qualified new rail infrastructure expenditures.*

## **Background**

**Tax expenditures.** California law allows various income tax credits, deductions, exemptions, and exclusions. The Legislature enacts such tax incentives to compensate taxpayers for incurring certain expenses, such as child adoption, or to influence certain behavior, such as charitable giving. The Legislature uses tax incentives to encourage taxpayers to do something they would otherwise not do, but for the tax credit. The Department of Finance is required to annually publish a list of tax expenditures, which currently total around \$94.2 billion per year.

**Credits.** Tax credits reduce the amount of tax owed by a taxpayer on a dollar-for-dollar basis. Credit amounts that exceed the taxpayer's current tax year liability can either be refunded to the taxpayer or carried forward to reduce tax in future years. However, except for the Earned Income Tax Credit, the Young Child Tax Credit, the Foster Youth Tax Credit, and the Motion Picture and Television Production Credit, all credits against California Personal Income and Corporation Tax are nonrefundable.

**Shortline railroads.** Class II and Class III railroads, commonly referred to as short line railroads, are the "first-mile, last-mile" of the freight rail network. According to the California Public Utilities Commission, there are two Class I railroads, no Class II railroads, and 24 Class III railroads in California.<sup>1</sup> Short line railroads link communities to the broader national rail system and serve farmers, miners, energy producers, port facilities, grain elevators, and countless other businesses that rely on efficient, reliable rail service to move goods to local and international markets. Shortline railroads incur ongoing maintenance costs and are investing in infrastructure modernization to improve energy efficiency, among other initiatives.

**IRC 45G Railroad Track Maintenance Credit.** Federal law provides a 40% business tax credit for qualified railroad track maintenance expenditures paid or incurred by an eligible taxpayer during the taxable year. An eligible taxpayer means any Class II or Class III railroad, and any person who transports property using the rail facilities of a Class II or Class III railroad

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<sup>1</sup> <https://www.cpuc.ca.gov/industries-and-topics/rail-safety/railroad-operations-and-safety/rail-operations-regulated-california-railroads>

or who furnishes railroad-related property or services to a Class II or Class III railroad. The credit is limited to \$3,500 times the number of miles of railroad track (1) owned or leased by an eligible taxpayer as of the close of its taxable year. California does not conform to IRC 45G for state tax law purposes.

**State grant program.** In 2019, the Legislature enacted the Short-Line Infrastructure Improvement Act, requiring the California Transportation Commission (CTC) to create a competitive funding program for short-line railroad infrastructure projects (SB 87, Hurtado). SB 87 included a one-time appropriation of \$7.2 million from the Trade Corridors Improvement Fund for the program. CTC subsequently created the Short-Line Railroad Improvement Program to fund projects such as railroad reconstruction, maintenance, upgrade, or replacement for short-line rail infrastructure. Grant funds were limited to projects submitted by the Department of Transportation (DOT), regional transportation planning agencies (RTPAs), or Class III railroads, if DOT or an RTPA sponsored their project. The CTC awarded project funding amounts according to the following limits: the grant funding cannot exceed 50% of the total project cost, at least 30% of the total project cost must come from nongovernmental sources, and funding to an individual project cannot exceed 25% of the total funding available in a fiscal year.

The author wants to help shortline railroads invest in their infrastructure by authorizing tax credits for maintenance and new infrastructure.

### **Proposed Law**

Senate Bill 1287 enacts the Shortline Railroad Modernization Act of 2026, which would authorize two new credits against both the personal income and corporate tax for taxable years beginning in 2026. The first credit is for Class II or III shortline railroads in an amount equal to 50% of the “qualified shortline railroad expenditures” and the second is for “qualified new rail infrastructure expenditures”.

Regarding the maintenance credits for “qualified shortline railroad expenditures,” specifies:

- “Qualified shortline railroad expenditures” include costs paid or incurred for railroad infrastructure maintenance and capital improvements.
- The taxpayer must have expenditures certified by DOT to claim a credit.
- The certified credit amount for any specific taxpayer cannot exceed \$5,000 multiplied by the number of miles of railroad track owned or leased within the state by the taxpayer at the close of the taxable year for which the credit is claimed.
- Specifies that the aggregate amount of credits that may be allocated in a fiscal year for the maintenance credits shall not exceed seven million dollars (\$7,000,000).

Regarding the new infrastructure credits for “qualified new rail infrastructure expenditures,” specifies:

- “Qualified new rail infrastructure expenditures” means the costs paid or incurred for a new rail infrastructure project.
- The taxpayer must have expenditures for the project precertified by DOT, and the project must commence within 12 months of the issuance of a credit precertification letter.
- The taxpayer must have their expenditures certified by DOT at the conclusion of the project to be issued a credit certification.

- The credit amount certified by DOT shall be limited to \$1,000,000 per new rail infrastructure project completed in the taxable year for which the credit is claimed.
- The aggregate amount of credits that may be allocated in a fiscal year for the new rail infrastructure credit shall not exceed \$10,000,000.

Regarding both the maintenance credit and the new rail infrastructure credit, specifies:

- Unallocated credits may be carried forward to future fiscal years for allocation.
- The taxpayer must submit applications for precertification and certification in the form and manner prescribed by DOT to be allocated a credit.
- The credit is allowed for the taxable year in which DOT issues the credit certification.
- Excess credit claimed to be carried to the following taxable year, and succeeding five taxable years, if necessary, until the credit has been exhausted.
- Allocated credits follow specific procedures when assigned or distributed.

The bill also defines several terms and contains findings and declarations to comply with Section 41 of the Revenue and Taxation Code.

### **State Revenue Impact**

Pending.

### **Comments**

1. Purpose of the bill. According to the author, “Short line railroads are a vital part of California’s freight network, both for local industries and rural communities that depend on reliable rail access to reach statewide and global markets. The most recent California State Rail Plan underscores the importance of strengthening freight rail infrastructure to support economic growth, improve system resilience, and advance the state’s climate and equity goals. SB 1287 provides a targeted tax credit that helps short lines modernize aging track and bridges, which will help reduce truck traffic on highways, and ensure small and mid sized shippers have dependable, low emission freight options. This bill supports cost effective investments that keep goods moving efficiently while aligning with California’s long term vision for a cleaner, more integrated transportation system.”

2. “Windfall” or “but for” tax benefit? Tax expenditures produce two different outcomes. The first outcome is a “windfall,” in which the tax expenditure rewards behavior that would have occurred regardless of the tax benefit. The second outcome is a “but for tax benefit,” where a particular activity would not have occurred without the incentive created by the tax expenditure. Here, SB 1287’s shortline-maintenance credit likely would be a windfall, because the bill covers many baseline maintenance items such as rail, tie plates, switches, ballast, subgrade, bridges, sidings, safety barriers, and crossing signals that at least some shortline rails would have to repair or replace anyway to keep service operating. On the other hand, the bill offers a cost-share-like arrangement for new infrastructure that may not have been prioritized, but for the credit. Therefore, this credit may serve as a partial but-for tax benefit because it could move some deferred or otherwise unfunded shortline rail projects forward.

3. Revenue loss. Existing tax law provides various credits, deductions, exclusions, and exemptions for certain taxpayers. By authorizing credits against personal income tax, SB 1287

will result in the State General Fund receiving less revenue. As a result, the state will have to reduce spending or increase taxes to offset the loss.

4. Precedent. If the Legislature authorizes tax credits for capital infrastructure maintenance and improvements for private shortline rail companies, why should it not extend the same treatment for Class I railroads, the trucking industry, or air carriers? This may lead to a slippery slope where other industries are authorized credits for capital infrastructure maintenance and improvements, thereby eroding the income tax base.

5. Fair? The maintenance credit is first-come, first-served; the new-infrastructure credit uses quarterly application windows and prioritizes projects that provide critical rail access to industrial parks, ports, adjacent economic development projects, and certain targeted sectors, such as value-added agriculture, advanced manufacturing, distribution/supply chain solutions, and sustainable manufacturing. The maintenance credit's first-come, first-served certification structure is administratively simple but favors applicants with better advisors and faster filing capacity rather than those with the greatest need. The new infrastructure credit, while more administratively complex, can be viewed as fairer because of its quarterly application windows. However, it still favors certain industries and project types by design.

6. Short Line Rail Improvement Plan (SLIP). The DOT was expressly tasked with identifying scenarios to fund improved industrial access and more efficient short-line operations.<sup>2</sup> The plan found that California short lines reported more than \$130 million in infrastructure needs. SLIP, among other suggestions, outlined a 50% per-mile credit model and noted that tax credits can encourage ongoing maintenance without forcing applicants into a competitive funding queue.

7. Keepin' it classy. The federal Surface Transportation Board defines Class II and Class III for shortline railroad designations at 49 CFR 1201, 1-1. The regulation classifies carriers into three classes using revenue thresholds adjusted by the railroad revenue deflator formula.

- Class I carriers have annual carrier operating revenues of \$900 million or more;
- Class II carriers have revenues of less than \$900 million but more than \$40.4 million; and
- Class III carriers have revenues of \$40.4 million or less.

Additionally, Class III carriers include all switching, terminal companies, and all electric railway carriers, regardless of their operating revenues.

8. Who benefits? In addition to the credit's financial benefit to shortline railroads, the state of California also stands to benefit: from increased operational efficiencies in shortline railroads. Because shortline railroads provide critical first-mile and last-mile connections to the national rail network, they preserve freight access for local industries and reduce reliance on trucks. As a result, one loaded shortline railcar displaces 3.6 truck trips, which helps lower emissions, relieve highway congestion, and reduce wear on publicly funded roads. According to the Short Line Railroad Association, without the credit, shortline carloads are projected to increase by 1% year over year. However, with the credit, the carload increase is expected to double to 2% year over year. By 2036, the credit would divert approximately 7.7 million additional truck miles compared to if it were not authorized.

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<sup>2</sup> <https://dot.ca.gov/-/media/dot-media/programs/rail-mass-transportation/documents/20220520-tr-slipr-to-a11y.pdf>

9. Joining the party? In 2019, the Legislature considered AB 1397 (Burke), a shortline rail tax credit substantially similar to SB 1287's maintenance credit. However, the measure failed to advance from the Assembly Revenue & Taxation Committee. Currently, at least 13 states have state tax credits aimed at short-line or Class II/III rail infrastructure: Alabama, Arkansas, Florida, Georgia, Indiana, Kansas, Kentucky, Minnesota, Mississippi, Nebraska, Oklahoma, Oregon, and South Carolina.

10. Section 41. Section 41 of the Revenue and Taxation Code requires any bill enacting a new tax expenditure to contain, among other things, specific goals, purposes, and objectives that the tax expenditure will achieve and detailed performance indicators, along with data collection and reporting requirements (SB 1335, Leno, 2014). A bill that would authorize a new gross income exclusion is exempt from the requirement that the bill contain detailed performance indicators and data collection reporting if the Legislature determines there is no available data to collect and report (AB 3289, Committee on Revenue and Taxation, 2024). To satisfy these requirements, SB 1287 states that its specific goals, purposes, and objectives are:

- Improving the safety, reliability, and efficiency of shortline and regional rail service, consistent with the 2024 California State Rail Plan.
- Preserving and enhancing rail access for existing industrial, agricultural, and commercial shippers, and facilitating new rail-served economic development.
- Supporting the diversion of freight movement from trucks to rail by preserving and expanding rail infrastructure capacity, thereby reducing highway congestion, pavement damage, and vehicle emissions.
- Supporting job retention and job creation in rail-dependent industries and associated supply chains through increased private capital investment in rail infrastructure.

The detailed performance indicators include: the number of miles of railroad track improved, rehabilitated, or constructed as a result of projects receiving the credit; the number and type of rail infrastructure projects completed, including track, bridges, sidings, and spurs; and the private capital investment leveraged by the tax credits, expressed as a ratio of private dollars invested per dollar of tax credit claimed. The data used to determine whether the tax credits are meeting the specified goals includes a description of each project for which a credit was claimed, the amount of qualified expenditures incurred, and the amount of credit claimed. As introduced, the bill does not assign an agency to report on the goals and performance indicators.

11. Double-referred. The Senate Rules Committee ordered a double referral for SB 1287: first to the Committee on Revenue and Taxation, and second to the Committee on Transportation.

12. Committee amendments. In both credits, Committee Staff recommends amendments to:

- Exclude from qualified expenditures costs paid or incurred more than 12 months before the date the qualified taxpayer submitted their application for credit certification.
- Require that qualified expenditures are only for unreimbursed costs and exclude any cost that was used as a basis for a federal or state credit or grant.
- Remove the provisions pertaining to credit distribution and assignment.
- Authorize that ability to sell the credits to unrelated persons.
- Require that any state deduction or credit be reduced if the same qualified expenditure is used for the purposes of claiming the credit authorized by this act.

- Require additional information in the applications for credit pre-certification and certification necessary for DOT and the FTB to calculate credit amounts and determine if a taxpayer meets the criteria of a “qualified taxpayer.”
- Authorize the FTB to disallow a credit if the taxpayer does not meet the required criteria to claim the credit.
- Assign DOT as the agency for the Section 41 report and require that they submit their report, in collaboration with the FTB, to the legislature annually.
- Sunset the credits after five years.
- Make other technical amendments.

In the credit for “qualified shortline railroad expenditures”, amendments to:

- Authorize the credits for tax years beginning in 2027, which is the first year taxpayers could receive a credit certification from DOT for “qualified shortline railroad expenditures” and claim a credit.
- Exclude from the definition of “qualified taxpayer” owners or lessees of a rail siding, industrial spur, or industry track located on or adjacent to any railroad in California.

In the credit for “qualified new rail infrastructure expenditures”, amendments to:

- Authorize the credits for tax years beginning in 2028, which is the first year taxpayers could receive a credit certification from DOT for “qualified new rail infrastructure expenditures” for which they received a credit precertification letter and claim a credit.
- Require DOT to begin reviewing pre-certification applications in 2027.
- Require taxpayers to submit their expenditures for credit certification annually.
- Amend the definitions of “qualified taxpayer” to exclude Class I railroads.

### **Support and Opposition** (4/3/26)

Support: California Short Line Railroad Association (Co-Sponsor)

Genesee & Wyoming Railroad Services, Inc. (Co-Sponsor)

Central Valley Ag Group

City of Oakdale

Copper and Gold, LLC

Empire Mining Co., LLC

Garden Grove Chamber of Commerce

Harbor Association of Industry and Commerce

Huron Transfer, LLC

JS West and Companies

Patriot Rail

Redondo Beach Chamber of Commerce

Solano Economic Development Corporation

South Bay Association of Chambers of Commerce

Superior Soil Supplements

Titan Terminal and Transport

Truck-Rail Handling, Inc. & Quality Transport, Inc.

Tulare County Resource Management Agency

Tuolumne County Transportation Council

Ventura Transfer Company  
Wilmington Chamber of Commerce

Opposition: California Tax Reform Association  
California Teachers Association

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