

**Milford-Bennington Railroad Co., Inc.**

**v.**

**Department of Revenue Administration**

**Docket Nos.: 19937-03RR and 20585-04RR**

**PRELIMINARY DECISION**

The “Taxpayer” appeals the RSA ch. 82 (Taxation of Railroads) assessments for tax years 2003 and 2004 by the New Hampshire Department of Revenue Administration (“DRA”). The board is authorized to review and determine the correctness of the DRA’s action de novo under RSA 82:17, but the Taxpayer, as the party challenging the assessments, has the burden of proof.

The Taxpayer challenges the assessments because:

- 1) although it is a railroad, its operations are conducted on state-owned property (real estate and trackage) and, by reason of statutory amendments enacted in 1999 and 2002, the “user fees” paid by the Taxpayer are “in lieu of” the railroad tax specified in RSA ch. 82;
- 2) in the alternative, if the Taxpayer is subject to a railroad tax, the DRA’s assessments are erroneous and not in compliance with the statutes, as amended; and
- 3) the assessments should be abated in full.

The DRA argued the assessments were correct because:

- 1) all railroads, including those operating on state-owned property, are required to pay a tax and

this tax is distinct and separate from the user fees paid under the Taxpayer's operating agreement with the state;

2) RSA 82:7 requires the DRA to take "the value of the railroad operating agreement" into account when assessing the railroad tax; and

3) demonstrating flaws in the methodology used by the state to assess the tax is an insufficient ground for an abatement.

### **Board's Preliminary Rulings**

The board finds the Taxpayer is subject to the railroad tax specified in RSA ch. 82. The board further finds, however, that some refinements of the DRA's assessments are required by the applicable statutes and the DRA should be given additional time to do so before the board renders a final decision on these appeals. The basis for these findings is presented below.

RSA 82:2 requires "every railroad" to "pay to the state an annual tax, . . . upon the actual value of its property and estate." (Emphasis added.) Railroads have historically operated on privately-owned or state-owned and leased rail corridors. They have been subject to a specific state tax since at least 1842. See, e.g., Boston & Maine R.R. v. City of Concord, 78 N.H. 192 (1916).

In more recent times, the state has acquired certain private rail corridors with existing trackage in order to preserve them and to meet present and future transport and recreation needs. According to a New Hampshire Department of Transportation ("DOT") witness (Christopher Morgan, Administrator of the Bureau of Rails and Transit), the state now owns approximately 500 miles of either active or abandoned rail corridors and this ownership includes approximately 26 miles between Wilton and Hillsborough.

Beginning in 1989, the Taxpayer reached an agreement with the state to utilize a portion of this corridor (18.61 miles). Under the original July, 1989 Operating Agreement, the Taxpayer

was obligated to pay a fixed annual sum (\$17,000), described as “financial participation,” to use this corridor. The state, however, waived payment until the Taxpayer began actual use to transport freight in 1992. See Taxpayer Exhibit No. 1, Section 5.1; and Taxpayer Exhibit No. 2. Beginning in that year, the Taxpayer has used the corridor to transport crushed rock for its sole customer from a quarry in Wilton to a processing plant in Milford (a distance of 5.5 miles, which includes 3 miles of the state-owned corridor and 2.5 miles owned by another railroad, the Boston & Maine Corporation).

In a subsequent Operating Agreement dated August 1, 1999, the parties changed the payment obligation from a fixed sum to five percent of “freight operating revenues as a users [sic] fee to the State.” See Taxpayer Exhibit No. 3, Section 4.3.1. As noted by the Taxpayer, both the 1989 and 1999 Operating Agreements obligate the Taxpayer to expend at least 20% of its annual operating revenues on track maintenance activities and to purchase and maintain liability insurance naming the state as a co-insured. Cf. Taxpayer Exhibit No. 1 and 3, Section 3.2.2.1 and 1.11.

As noted above, the parties fundamentally disagree on the central issue of whether the Taxpayer, because of these contractual arrangements enabling it to use the state-owned rail corridor, is subject to railroad taxes at all. This disagreement is based primarily on their conflicting readings of certain statutory amendments enacted in 1999 and 2002. A review of the relevant statutes, as amended, in light of the relationship between the Taxpayer and the state, is therefore necessary to decide these appeals.

RSA 72:23, I (a) contains a general exemption of property owned by the state (and its subdivisions) from municipal taxation. RSA 72:23, I (b) provides, however, that this exemption is not applicable when such property is leased, used and occupied by others. A 1999 amendment to subparagraph (b) further states: “This subparagraph shall not apply to leases of state-owned

railroad properties which are subject to railroad taxes under the provisions of RSA [ch.] 82.” A further amendment in 2002 added the following phrase to this sentence: “or which provide revenue to the state, a portion of which is distributed to cities and towns pursuant to RSA 228:69.”

While these amendments can be read to relieve the Taxpayer from municipal taxation, they do not confer an exemption from the state railroad tax because RSA 82:7, as also amended in 1999, confirms that “railroads operating on state-owned property” are subject to this separate tax. This statute provides “the determination of value shall not include the value of the trackage owned by the state, but shall be based upon the value of the railroad operating agreement as determined by the user fees paid into the fund established pursuant to RSA 228:68.”

The Taxpayer nonetheless argues the “user fees” paid under the Operating Agreement should substitute for railroad taxes otherwise payable. This interpretation was apparently shared by Carol Murray, the DOT commissioner. In a November 28, 2001 letter to the DRA commissioner (Taxpayer Exhibit No. 7), Ms. Murray stated: “In effect the user fee became the railroad tax for these operations.” The board disagrees with this statement and the Taxpayer’s arguments for several reasons.<sup>1</sup>

First, if the legislature meant to exempt railroads operating on state-owned trackage from the railroad tax entirely, or, for that matter, wanted “user fees” paid under operating agreements to take the place of the railroad tax itself, these outcomes could have been stated plainly and

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<sup>1</sup> In light of this resolution of the statutory issues involved, the board finds the DRA’s “Motion in Limine” to exclude testimony by certain witnesses regarding “legislative intent” to be moot. The witness testimony and the above DOT letter presented by the Taxpayer, for that matter, carry no weight on the questions of statutory interpretation addressed by the board. In other words, the board has focused on the meaning of the statutes as enacted, not what participants or observers of the legislative process, such as present or former state officials or employees, might think it means or was intended to mean. Cf., Bradley Real Estate Trust v. Taylor, 128 N.H. 441, 446-47 (1986); Hurley v. Public Service Co. of New Hampshire, 123 N.H. 750, 754-55 (1983); and Corson v. Brown Products, Inc., 119 N.H. 20, 23 (1979).

directly. There are at least two statutes involving taxation of railroads where the legislature has done just that: in RSA 82:38, enacted in 1965, and RSA 82:25-a, enacted in 2001, the legislature provided plain and direct exemptions from the state railroad tax for the “Mount Washington Cog Railway” and “amusement railroads,” respectively, and further provided the property owned by these railroads is subject to ‘appraisal and taxation’ under RSA ch. 72 (by the municipality).<sup>2</sup> In contrast, the legislature has not granted an exemption from the state tax to railroads operating on state-owned corridors: both RSA 82:7 and RSA 72:23, I (b), quoted above, make it clear that “railroads operating on state-owned property” are subject to the tax.

Second, while the 1999 amendment to RSA 82:7 refers to “user fees” paid by “railroads operating on state-owned property,” it states they are to be used to determine the value of the operating agreement (instead of an alternative assessment based on “the value of the trackage and real estate owned by the state”). By referring to the “value of the railroad operating agreement,” the legislature recognized it to be an asset subject to assessment under the railroad tax, albeit one that may be somewhat more difficult to value. Such difficulty, however, does not preclude taxation.

In this case, the Operating Agreement gives the Taxpayer the right to conduct its freight transportation business over a rail corridor owned by the state. Without the Operating Agreement, the Taxpayer’s business could not exist and therefore the Operating Agreement confers value on the business, albeit a value directly dependent on the amount of user fees: all other things being equal, higher user fees (expenses to the business) diminish the value of the Operating Agreement and lower user fees increase its value to the Taxpayer. This perspective suggests an income approach with appropriate refinements, as explained further below, can provide a reasonable method of estimating the “value of the operating agreement,” which the

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<sup>2</sup> See RSA 72:12: “All real estate of railroads and other public utility corporations and companies which is not taxed under RSA 82 and 82-A shall be appraised and taxed by the authorities of the town in which it is situated.”

DRA is required to do under the 1999 amendments to the above statutes.

The Taxpayer further argues the distribution of the “special railroad fund” established by the legislature in RSA 228:68, which includes the user fees and track maintenance fees paid under the Operating Agreement, supports its position. Under amendments enacted in 1999, 20% of the “receipts from each railroad operating agreement” are to be distributed annually back to the cities and towns through which the active state-owned railroad lines operate. RSA 228:69 This provision, however, does not mean or imply the user fees are a substitute for the railroad tax, but simply directs how a portion of the proceeds from the rental of state-owned property is to be allocated.

Thus, the board finds railroads operating on state-owned property, including the Taxpayer, are subject to taxation under RSA ch. 82. Assessment of this tax does not result in inequity or place the Taxpayer at a disadvantage compared to railroads operating on private rail corridors that are also subject to the tax.

An analogy can be drawn to renters of private property who may both pay rent to the property owner and still be held responsible to pay taxes on that property (if the lease so provides). If, for example, instead of rail property a state-owned office building is involved, a private tenant is obligated to pay taxes on the value of property rented from the state and, by statute, the lease must include this obligation. See RSA 72:23, I (b). Here, the state is in effect renting other property it owns (real estate and trackage) to the Taxpayer and the Taxpayer is obligated to pay, instead of a municipal tax, the state railroad tax under RSA 82:7.<sup>3</sup> Just as rental payments do not necessarily insulate a renter from having direct property tax obligations, the board finds payment of user fees do not insulate the Taxpayer from the state railroad tax. To find otherwise would result in inconsistencies in the incidence of tax, depending upon whether a

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<sup>3</sup> Cf. Section 1.3 of the 1999 Operating Agreement (Taxpayer Exhibit No. 3), which requires compliance with “all applicable laws, rules, regulations, and orders,” including those of the DRA. (No specific mention of the DRA is contained in the earlier 1989 Operating Agreement., Taxpayer Exhibit No. 1.)

railroad owns or leases (from the state) the rail corridor over which it operates.

As noted above, the board finds the “value of the physical property, real and personal” (specified in RSA 82:7) can be estimated using an income approach, which deducts from the revenue stream the expenses associated with them (which should include the user fees payable under the operating agreement), and then applies an appropriate capitalization rate to the resulting net operating income.

The railroad tax is imposed on the “actual value of [the] property and estate” of each railroad. See RSA 82:2; 82:4 and 82:6. RSA 82:7 (Evidence and Value) further directs the DRA to consider “the value of the physical property, real and personal” of the railroad in determining actual value and provides, in some detail, how the DRA should do so. The second sentence of RSA 82:7 directs the DRA:

“When the market value of the stocks and bonds [of the railroad entity] cannot be ascertained for want of actual sales, or for any other reason, the net receipts of any such corporation or company, which shall be the difference between the gross earnings, whether by lease or by operation, and the operating expenses and taxes of the preceding year, capitalized at such percent as appears to be equitable under the circumstances, shall be considered as evidence of the value of the property and estate of such corporation or company.”

As so defined, application of a “net receipts” concept is essentially an income approach to determine taxable value in circumstances where there is no readily ascertainable market (“want of actual sales”) for the railroad’s “stocks and bonds.”

Further, the statute infers the cost approach may not be applicable when, as in this case, the railroad operates on “trackage and real estate owned by the state....” In these instances, “the value of the physical property, real and personal...” of a railroad is best estimated utilizing the income approach which includes in its income and expense calculations any revenue and expenses that the operating agreement (leasehold value) contributes to the railroad’s overall value.

The board interprets the last sentence of RSA 82:7 to include any value the operating agreement may have in calculating the total taxable value of the Taxpayer for RSA ch 82 purposes as a parallel method to valuing the real estate and trackage for railroads that own those components in fee. Both situations include the generation of revenues from hauling freight on tracks with the concomitant expenses (maintenance, insurance, etc.). A careful review of income and expenses in either situation, when capitalized, should provide a reasonable basis for assessing the RSA ch 82 tax.

In other words, an income approach can be applied to a railroad that has negotiated and obtained an operating agreement to use state-owned trackage (instead of its own property) and can capture the leasehold value of that agreement by utilizing the revenues that agreement allows the railroad to generate less the expenses associated with the agreement and all other appropriate expenses to arrive at a net operating income to be capitalized. Upon remand, the DRA is directed to use such an income approach to estimate a proper value of the Taxpayer's taxable property which is inclusive of any leasehold value of the Operating Agreement.

The Taxpayer correctly notes some errors on the part of the DRA in the assessments prepared for tax years 2003 and 2004. The Taxpayer points out, for example, an obvious error in the DRA grid estimating "average" net operating income (NOI) for 1998 through 2001 which was produced in response to the Taxpayer's discovery request: this grid erroneously excludes from allowable expenses substantial rents paid to Boston & Maine in 1998, 1999 and 2001 simply because they are shown on a different line ("Rents" rather than "Tracking Rights") on the prepared grid.

To arrive at a proper railroad tax assessment, the DRA is specifically required by the legislature to estimate "the value of the railroad operating agreement" as part of its determination of "the actual value of the property and estate" of the Taxpayer under RSA 82:7 and 82:6. The

errors complained of by the Taxpayer may have arisen because the DRA used a standardized appraisal report format for all public utilities subject to its assessment authority, rather than one focused more particularly on the contractual arrangements and the valuation statute applicable to the Taxpayer.

The board therefore directs the DRA to prepare and submit, within thirty (30) days of the date of the Clerk's date shown below, with a copy to the Taxpayer, revised and corrected assessments for tax years 2003 and 2004, adopting suitable refinements based upon the statutory requirements discussed above and providing support and detail for all relevant figures and assumptions employed to estimate the value of the taxable estate under RSA ch. 82. The Taxpayer shall then have thirty (30) days to submit written comments to the board in response to the DRA's submission, noting and discussing in sufficient detail any proposed modifications or corrections. The board will consider these respective submissions before making a final decision regarding the proper assessments for each tax year under appeal.

SO ORDERED.

BOARD OF TAX AND LAND APPEALS

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Paul B. Franklin, Chairman

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Douglas S. Ricard, Member

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Albert F. Shamash, Esq., Member

**Certification**

I hereby certify a copy of the foregoing Preliminary Decision has this date been mailed, postage prepaid, to: William R. Drescher, Esq., Drescher & Dokmo, P.A., PO Box 7483, Milford, NH 03055, counsel for the Taxpayer; Michael R. Williams, Esq., State of New Hampshire Department of Revenue Administration, 45 Chenell Drive, Concord, NH 03301, counsel for DRA; John F. Hayes, Esq., State of New Hampshire Department of Revenue Administration, 45 Chenell Drive, Concord, NH 03301, counsel for DRA; and Stephen G. LaBonte, Esq., State of New Hampshire Department of Justice, 33 Capitol Street, Concord, NH 03301-6397, Interested Party.

Date: July 28, 2006

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Anne M. Stelmach, Clerk