PROPERTY TAX WORKING GROUP
FINAL REPORT
AUGUST, 2007

INTRODUCTION

The objectives of the FCA Property Tax Working Group were to review the present system, identify its problems, review alternatives and propose a system that addressed the problems. The principal goal was to select a system that is fair, consistent and easy to understand.

After some discussion, it was decided to focus on residential tax, as the group lacked the necessary background and understanding to review commercial and industrial taxation.

The current system of Current Value Assessment (CVA) is a market value assessment system that uses an estimate of an individual property value by looking at sales of comparable properties in the same neighbourhood. The assessment is calculated by a provincial agency, the Municipal Property Assessment Corporation (MPAC), using a confidential formula. Assessments are revised every three years. To calculate the tax on an individual property, the municipality divides its total financial needs for the year by the total assessment of all properties, giving a tax or "mill" rate. The individual property tax is calculated by multiplying the assessment by the tax rate. It is worth noting that the CVA system does not come cheaply, as the cost of MPAC is borne by the municipalities. For Ottawa, this is some $10 million a year, or more than $11 for every individual regardless of age.

The CVA system seems to work well in environments where changes in property values are consistent across the municipality. Thus individual tax bills remain relatively constant, with any changes in tax due to changes in the municipal tax rates rather than due to reassessment impacts. Where property owners find CVA unsatisfactory is when there are major assessment increases in some areas compared to the rest (as an area becomes "trendy"), so they are hit with large tax increases. The homeowner has done nothing to justify the extra tax and receive no extra services for their increased contribution to the tax coffers. It is interesting to note that tax payers in outlying and suburban areas, whose properties have gone up less than the average for their municipality, have been content to watch above average increases in the urban core while their taxes have dropped. However, when their assessments eventually rise faster than average (as happened in Toronto with the last re-assessment), they are suddenly far less satisfied with CVA.

The proposed system addresses this volatility issue with a method that is consistent for the individual taxpayer and simple to understand and implement. It also recognized that moving to a system which is not property value assessment-based would not be viable in the foreseeable future, thus perpetuating the current system unnecessarily.

CURRENT SYSTEM ISSUES

The problems with the current system are:

- Volatility - rapidly changing assessments due to an area's popularity leading to massive tax increases with no additional services causes distress and insecurity about being able to keep your home.
- Renovation - the system penalizes you for maintaining and fixing up your home
- There is no correlation between taxes paid to services consumed, so you do not pay for what you use.
- Assessment rules are secret, so you cannot tell how your assessment was derived. The results do not appear to be consistent
- The assessment is an estimate made by a bureaucracy, whereas other taxes are based on firm numbers and are transparent.
- Areas of provincial responsibility, such as education and social services, are placed on the property tax base. For social services, the city has no control over the cost of these provincially mandated programmes.
- Different bases are used for calculating residential, commercial and industrial assessment (e.g., commercial is based on rental value, not property value)
- The system is not easy to understand
- The system does not encourage frugality and does not match costs to services
- The system is regressive and is not based on ability to pay
- Tax benefits of large events do not come to the city. For example, the Grey Cup required the City to pay overtime for policing and transit, but the sales taxes all went to the federal and provincial governments.
- It can be harder for municipal governments to raise taxes when required because some residents have already received significant tax increases due to property reassessments and will oppose such increases.
- The system acts as a capital gains tax before there is an actual capital gain on the only class of asset which is exempt from capital taxes (primary residence).

PROVINCIAL PROGRAMMES

The responsibility for a variety of social programmes have been downloaded to the municipalities by the province. In addition the province sets standards, leaving the municipality to pay the tab without any control on the cost. This approach is unfair for two reasons. First, a municipality that suffers a major economic setback (e.g., the high tech meltdown in Ottawa in 2001) is likely to have significant increased demand for welfare and social housing, yet is least equipped to pay for it. Second, those needing social services tend to gravitate to larger centres, where more services are available and there are more individuals sharing their situation. This places an extra burden on the larger centre's taxpayers as larger centres have a proportionately larger number of people seeking social services such as welfare and housing.

Currently every year Ontarians pay $237 more per person in property taxes compared to other Canadians. The province pays $258 less per person for health and social services than the rest of Canada. This means some $3 billion a year is downloaded onto the property tax base. This creates huge burdens for municipalities struggling with increasing costs and crumbling infrastructure.

RECOMMENDATIONS

A) General

1) The first recommendation of the Working Group is that governments should pay for the social programmes that they mandate. Social services financing logically belongs on the provincial government, which spreads this cost fairly over all residents. Extending this philosophy also means education should be financed by provincial taxation and removed from the property tax base. This means that funding for social services, which can fluctuate given the general state of the economy will not be funded by the most stable of tax bases, the property tax. This will allow municipalities some tax room to finance their programmes like infrastructure renewal and public transit. It should be noted that the method used for implementing provincial programmes does not necessarily mean the province assumes full responsibility for operating them. Local management, such as is done with school boards, can be used.

2) Municipal services that can easily be measured by usage should be paid based on actual use rather than from the property tax. This would include services such as water/sewers and garbage collection. Not only will this put the cost on the user but will likely result in people being more prudent in their use of such services.

B) Property Tax System

The Working Group spent some time reviewing a wide variety of options, including unit assessment (based on size of property/buildings), frontage, head (poll) tax and flat tax. It also discussed better tying in taxes to services used, such as more user fees and location-based taxation. While these may be future possibilities, it was decided this should be left for future analysis.

The system developed by the Group applies to residential property. Each property will have an "assessed" value. The municipality will calculate tax as today, by dividing money needed by total assessment to develop a tax rate and then multiplying assessment by tax rate. What changes is how assessment value is calculated. The base value will be the actual purchase price. Each year after the purchase, the assessment will be adjusted by the percentage change in the average property sale price for that municipality during the previous year. Thus, if property values rise by an average of 5% over the year, the following year all assessments are increased by 5%, but the property owner still has the same share of the tax burden as their house is still the same price relative to every other house. When space is added to a building on a property, the addition value will be calculated using standard values (as is done for building permits) and added to the assessment. There will be no changes in assessment for upkeep or inside enhancement (such as kitchen renovation), unless space is added. Once the assessment base is set, it is fixed unless the building is demolished (all or partly) or until the property is sold. Once the property is sold, the new sales price will be the base for future taxes. This new price will increase each subsequent year in a similar manner to all other residents. An Assessment Review Board function will be required to review any special cases that arise.

Some of the implementation details:

- The purchase price will be confirmed as fair and accurate by having the seller's lawyer and the real estate agents confirm this is an arm's length transaction at current market rates. This should avoid side deals to lower assessment value, as the professionals making the confirmation risk losing their licences.

- The province can easily calculate the average property value change for each municipality using information collected from land transfer tax transactions.

- Space added can be captured from the building permit and inspection process.

- When interior space is converted to living space, such as converting an attic to a bedroom or an unfinished basement to a family room or apartment, it is treated the same way as a physical addition.

- The insurance industry does an annual cost of construction value which sets a standard cost per square foot of construction. This can be used for setting the value of additions. A single value should be set for the province.

- As a starting base, the last assessment (2005) would be used as a baseline for all property owners. The annual average change will be applied to bring them to a current value. Any properties sold since 2005 will use their selling prices with annual adjustments applied as necessary to bring them current.

- The need for MPAC and its associated expense will be eliminated, freeing up money for municipalities across the province.

- For municipalities which have few sales annually, a 3 year running average could be used to prevent single year volatility.

NEW SYSTEM ADVANTAGES

The new system is:

- Predictable: For existing owners, they know their assessments will stay constant relative to other properties. Any increase in property tax will be due to an increase in taxes mandated by City Council. For new buyers and those making additions, they can predict their new tax bill and have some assurance it will not dramatically increase.

- The tax will no longer act as a capital gains because one would only pay a higher tax when they demonstrated their ability to do so by either putting on an addition or paying a higher price for the house than the previous assessed value (based on original price increased by the general housing price increase factor).

- No maintenance penalty: People can keep their property in good order and make changes within their walls without incurring extra tax.

- Open system: The approach is simple, with no hidden rules and large government bureaucracy required to administer it.

- Easier to understand: While many will still have some problem understanding exactly how municipal tax is calculated, they will realize their taxes will remain effectively constant unless the municipality raises the amount of tax to be collected.

- Ability to pay: While any property tax system is regressive and not tied to ability to pay, this system better ties into this concept. The purchaser can estimate taxes fairly accurately and know they should not dramatically change over time. Barring a major change in personal circumstances, taxes affordable today should be affordable tomorrow.

- Fair: While no regressive system can be totally fair, the proposed method better meets this criteria because it provides a consistent and predictable approach. The buyer knows what is to come and can decide accordingly. No one is penalized because their area suddenly becomes trendy and, through no action on their part, they are charged fro an unrealized capital gain on their property. nd the application of average increase each year should keep assessment values close to actual selling prices.

- Easy to implement: The system uses existing government operations to capture the necessary data.

ALTERNATIVE SYSTEMS

Three alternative proposals have been proposed by Ontario political parties. These are:

Fixed purchase value assessment (as proposed by the NDP): In this system, the purchase price of the property would be the assessment and remain in place until the property is sold. In this system, if selling prices rise, the established owner sees his portion of the total assessment fall as his price is left constant while the over all value of property is increasing due to new purchases. Thus, tax may be reduced. This compounds over time. If property values rise by 6% a year for 12 years, the buyer of a property will pay twice the tax of the long term owner. This is far less fair, as it makes for unequal tax burdens and major inconsistencies. New owners will be very heavily penalized.

Five per cent cap (as proposed by the Progressive Conservative Party): This approach continues the current system, but sets a 5% maximum on the annual assessment increase. In the Group's view all this does is spread the pain of the current system over more years. It does not provide consistency or predictability, keeps the current secrecy and MPAC expense, punishes people for maintaining their homes at a high standard and in no way is it easier to understand or tied to ability to pay.

Move to a four year assessment cycle and spread increases evenly over the four years (as proposed by the Liberal Party): This has the same limitations as Progressive Conservative proposal and provides no cap on increases, so provides no protection from market volatility.

Annex 1 outlines the impact of the three tax proposals based on house prices increasing in a specific neighbourhood by 15% while overall prices are increasing by 10% in the municipality. The Liberal proposal is not included, as it gives the same results as the current system over time.

OTHER RECOMMENDATIONS

At the present time, not all the costs of new developments are charged to the development. This means the current taxpayers are subsidizing the cost of putting in city services. In future developers should be assessed the full costs of servicing their developments. This will help ensure people pay for the services they use.

Municipalities across the province are faced with major expenses, whether related to fixing failing infrastructure, adding required facilities or meeting public transit needs to address global warming, the demands are huge. These cannot be handled through property tax alone. The province must give municipalities the necessary tax powers to finance their needs.

In addition, the province must give cities their fair share of specific revenues. Gasoline and road taxes are collected by the province as revenue to maintain roads. Municipalities have vast networks of roads (including many former provincial highways), yet receive none of this road tax revenue. Similarly municipalities receive none of the sales tax revenue for activities within their boundaries, even though the municipality picked up the costs of promoting and managing. The province needs to commit a proportion of sales and road tax revenues, so the municipalities have a predictable revenue stream to help address their critical needs.

SUMMARY

The current system is both unpredictable and non-transparent using secret calculations to create an estimate of value by a government bureaucracy, penalizes property owners who maintain their property and can be highly volatile in dynamic real estate markets. It also completely ignores ability to pay. And it requires an expensive organization to administer it.

The proposal addresses these issues. It continues with an assessment-based system, which people comprehend, but eliminates the secrecy and complexity by going to open and easily calculated true values as set by the market, not a bureaucratic approximation of the market. It does not discourage upkeep of buildings and property. It provides for consistent taxation over the long term, as it is not swayed by market value changes. It also helps with ability to pay, since the purchaser can predict his new taxes and know major changes will only occur when the municipality raises the tax rate or major improvements are done. This is the same as other household expenses like heating and hydro, which change with inflation. Those making additions will also have predictable consistency. No longer will a modification costing $20,000 add $100,000 to the assessment. And the proposal eliminates the need for most of MPAC and the cost.

Whenever a new property tax system is proposed, taxpayers tend to look at whether their next tax bill will go up or down, and react accordingly. The proposed system will not mean dramatic changes for most taxpayers, except for the effect of going to the 2005 re-assessment. If the current system is maintained, taxpayers will still face the impact of the re-assessment. The province could eliminate this by staying with the previous assessment and applying annual adjustments for more years. A key for successful implementation of the new system will be to explain that a higher assessment does not mean more tax. More tax is payable only when assessment rises faster than the average and the proposed system prevents this.

The only taxpayer facing a large change in tax is the buyer in a “hot” market area, where selling prices have risen faster than average. The application of average value increases each year should help reduce some of the impact of trendiness. The buyer will know what the costs will be and make a purchase decision accordingly. And for all, once a purchase is made, the buyer knows the system protects against major increases due to the area becoming even hotter.

Because the proposal addresses the major issues with the current system without dramatic change to existing taxpayers, we call on the province to implement it as soon as possible.

Annex One
Comparison of Property Taxes

In all cases assume that the average house price is going up 10% in the municipality but in the area under review prices are going up approximately 15% per annum.

1) FCA Proposed System

House One – Purchased 2005 - $250,000,
House Two – Purchased 2005 - $250,000

Assume house prices increase by 10% per year on average

Tax Value of House One in 2010 - $402,630
Purchase Price of House Two in 2010 - $503,000 (based on 15% increase for area)

Ratio of Taxes Paid by House Two to House One After 2010 – 1.25

2) Fixed Purchase Price Assessment

House One – Purchased 2005 - $250,000,
House Two – Purchased 2005 - $250,000

House valuation remains constant until house is sold

Tax Value of House One in 2010 - $402,630
Purchase Price of House Two in 2010 - $503,000 (based on 15% increase for area)

Ratio of Taxes Paid by House Two to House One After 2010 – 2.01

3) Five Percent Cap on Assessment

House One – Purchased 2005 - $250,000,
House Two – Purchased 2010 - $250,000

Assume house prices increase by 5% per year

Tax Value of House One in 2010 - $303,876
Purchase Price of House Two in 2010 - $503,000 (based on 15% increase for area)

Ratio of Taxes Paid by House Two to House One After 2010 – 1.66