A LEVEL PLAYING FIELD BY 2009:

Achieving Property Tax Parity for Toronto Businesses

Executive Summary

A Report prepared for the Toronto Office Coalition

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January 31, 2006

RECOMMENDATIONS AND EXECUTIVE SUMMARY

The recommendations of this report are aimed at three public policy outcomes:

- Uploading responsibility for social assistance and social housing to the federal government. Recommendation 1 proposes an initial step aimed at this outcome – an outcome which could meet the new Conservative government's pledge to address fiscal imbalance.

- Implementing a ceiling rate for business education property taxes in Ontario, set equal to the 905 commercial average rate. Recommendation 2 proposes reaching this outcome by 2009 at the latest.

- Limiting municipal property tax increases on Toronto businesses – with an annual limit at or close to zero. Recommendation 3 proposes that the limit be added to the City of Toronto Act 2005, currently before the Ontario Legislature in Bill 53.

Achieving these outcomes would permit levelling of business property tax rates across the Greater Toronto Area – by 2009 if federal-provincial negotiations on fiscal imbalance move quickly enough:

- The GTA "tax gap" (a term quantified in the Introduction to this report) has been well documented in previous reports – going back to the Greater Toronto Area (Golden) Task Force report of a decade ago. The tax gap distorts investment location within the GTA. Toronto's business property tax rates are far higher than those in suburban municipalities, and are not offset by services provided to businesses. Instead of being driven by economic fundamentals, investment is artificially driven outside the Toronto boundary – an economic inefficiency that damages the City. It also compromises Ontario's growth management strategy for the region.

- To eliminate the tax gap, business property taxes in Toronto must be reduced by almost $1 billion / year. However, both the City and Ontario governments depend financially on the $1 billion revenue stream. Finding replacement financing is the key to corrective action.

RECOMMENDATION 1: *That the Advisory Panel on Fiscal Imbalance (appointed by the Council of the Federation) be requested to examine and report on uploading social assistance / social housing responsibility to the federal government.*

- The Council of the Federation is a joint agency of the provinces. The Council's advisory panel on fiscal imbalance, co-chaired by Professors Robert Gagné and Janice Gross Stein, will report this spring. The panel's report will help launch a process of policy development – a process the new federal government's election platform has moved to centre stage.

- The City (i.e. non-education) portion of the above-noted $1billion in excess taxes is about two thirds of the total. Uploading the City's social assistance / social housing costs would clear the path to eliminating most of that City portion; City cost savings would flow through to business property tax reductions.

- Flow-through of the City's savings to business property tax reductions might seem to imply a missed opportunity: the opportunity to shift current spending to new spending on unmet servicing needs in the City. However as will be indicated in Section 5, there may be an opportunity to reduce business property taxes and spend more on unmet servicing needs. It is not necessarily an either / or proposition.

- An upload of social assistance and social housing costs would lift a total of $2.2 billion / year in social assistance / social housing costs from municipal budgets across Ontario (almost $500 million of which would be in Toronto). Another $4 billion / year would be lifted from the Ontario provincial budget.[1]

- The new federal government's election platform includes a commitment aimed at correcting fiscal imbalance. Fiscal imbalance is corrected if all governments have revenues appropriately meeting their spending responsibilities. The platform commitment aims particularly at improving the financial position of provinces.

- The traditional route to improving provincial finances is a transfer of federal revenues or tax points. However, there is a second route which is highlighted in this report: uploading provincial spending responsibility to the federal level. The provinces could then use existing revenues to meet core responsibilities more effectively (e.g. health and education).

- The suggested upload would complement existing federal responsibilities (e.g. employment insurance and immigration). For Toronto, and for Ontario municipalities generally, there is an additional attraction: an automatic upload of municipal social assistance / social housing costs.

[1] Alone among provinces, Ontario has not uploaded social assistance and social housing costs. In other provinces, municipal expenditures in these fields are now minimal or non-existent. Federal assumption of responsibility would lift social program costs from all sub-national budgets: municipal budgets in Ontario would automatically be included.

- If fiscal imbalance is addressed by alternative means such as transfer of federal tax points to provinces, there is no automatic uploading from municipalities. Any upload of municipal costs would have to be to the provincial level, not to the federal level. While this upload might emerge as a by-product of the fiscal imbalance initiative, there is no certainty that it would. (Finding means to reduce this uncertainty, while not a primary focus of this report, is a subject touched on briefly in an Addendum to this Executive Summary.)

- Even with the suggested upload fully implemented, provinces and / or municipalities could continue as administrators of social programs under contract with the federal government. This continuing involvement could maximize efficiency of program delivery. At the same time, the federal government's financial resources could enable client benefits to be improved, for example by reducing benefit clawbacks when clients re-enter the labour force

RECOMMENDATION 2: That the Ontario Finance Ministry be requested to implement a province-wide ceiling rate for business education taxes – positioned at the average 905 commercial education tax rate – with phase-in beginning in 2006, ending no later than 2009.

- The ceiling rate would implement the education part of the proposed $1 billion / year tax reduction for Toronto businesses. As was noted above, municipal taxes account for about two-thirds of the $1 billion total. Education taxes account for the other third.

- There is still a wide range of education tax rates levied on Ontario businesses: all 2005 rates are attached in Appendix 3. This wide range is re-confirmed annually by the provincial government, which has set property tax rates for education since 1998.

- With school funding now based on a province-wide formula, there is no rationale for unequal tax rates. They are a legacy of the pre-1998 system, under which local school trustees set tax rates. With the ceiling rate recommended here, 86 percent of business education tax revenues would be levied at a uniform rate – the ceiling rate. The other 14 percent would still be levied at rates below the ceiling; these are legacy rates at the low end of the current range.

- Many businesses outside the GTA would also see substantial tax reductions under the ceiling-rate policy, for example in Windsor and Kingston where industrial education rates would be reduced by half. Total property tax savings for businesses across Ontario would be about $670 million / year.

- If the federal upload noted in Recommendation 1 proceeds, Ontario would have $4 billion / year in freed-up revenues. Allocating $670 million of the $4 billion to school funding would replace foregone property tax revenue from businesses. (If federal-provincial negotiations arrive at a different solution to fiscal imbalance, Ontario could dedicate part of its savings from that solution to school funding, again replacing the foregone revenue.)

- Alternatively, Ontario could take another route to making up foregone business property taxes: tax shifting onto the residential education tax base. Assuming a four-year phase-in, this shift would mean increasing the province-wide residential school rate each year from 2006 to 2009. Expressed as a percentage of total residential property taxes (education and municipal taxes combined), the increases would amount to only 1.5 percent per year. The tax shift thus appears easily manageable from a political standpoint.

- Whichever financing mechanism is preferred by the Province, a 2006 start to business education tax reductions is feasible. Assuming that fiscal imbalance negotiations will take a year or more, and that internal provincial funding is not available, the residential school rate would be increased on an interim basis for 2006. That would provide the funding for an immediate start to business education tax reductions.

- When negotiations with the federal government on the fiscal imbalance issue are concluded, the provincial government will have new resources at its disposal. If the Province decides to finance business education tax reductions with no tax shift to residential taxpayers, some of the new resources would be applied to rolling back interim residential rate increases. If the Province decides to let the education tax shift stand, new resources would be deployed for other purposes.

<u>RECOMMENDATION 3: That the Ontario Minister of Municipal Affairs and Housing be requested to move an amendment to the City of Toronto Act 2005, such amendment to provide for a maximum annual percentage increase in business property tax rates – at or below the 0.17% annual average currently projected by the City. This numerical limit would be incorporated into the text of the Act; it could not be increased via regulations under the Act.</u>

- As was noted under Recommendation 2, education tax reductions could reduce the annual property tax burden on Toronto businesses by almost a third of a billion dollars within four years (a 12 percent reduction of the total tax rate) This reduction can be expected to have positive impacts on Toronto's share of GTA development, but only if investors see education tax reductions as total tax reductions – i.e. not as a means to open tax room for the City (leaving the total tax rate unchanged).

- The City of Toronto Act 2005 – like the Municipal Act it supersedes in the City – provides for provincial control of business property taxes in Toronto. However, under both Acts this control is exercised via regulations. While regulations may be administratively convenient, their use tends to maximize investor uncertainty. Whether tax rates on businesses will go up or down is difficult to predict. Legislating a numerical limit on tax increases would reduce this unpredictability. In effect, the limit would be an "upset limit": regulations or discretionary City action could limit municipal tax increases still further – or convert them to decreases

- A legislated limit on tax increases is an inflexible policy instrument – precisely its virtue from the standpoint of investor certainty. To modify the limit, amending legislation would have to be passed by the Legislature.

- Investor certainty provides part of the rationale for a legislated limit on tax increases. More fundamentally, the rationale rests on economic efficiency. The GTA tax gap has a substantial distorting impact on business location – a conclusion based on econometric findings that will be summarized in this report. Accordingly, tax increases that add to the distortion – or prevent its being reduced by education tax decreases – should be placed in a difficult-to-access category of revenue sources. A further relevant consideration (noted in Section 5) is that increasing business property tax rates might yield little or no additional revenue.

- The City of Toronto Act 2005 gives the City new access to relatively efficient consumption-based taxes (e.g. tobacco taxes). Use of these taxes is preferable to increasing business property taxes from the economic efficiency standpoint.

- At the same time, the new Act requires the Legislature's consent if the City is to access other new taxes. Effectively, a difficult-to-access category of revenue sources is already embedded in the Act – but not yet extended to the property tax field. A statute applying only to one municipality is well suited to inclusion of specific property tax policy provisions, with less reliance on regulations. The Municipal Act, which applies to hundreds of municipalities, would be more difficult to re-draft along the lines proposed here.

- The City of Toronto has recently adopted a tax policy framework featuring gradual tax shifting from business to residential property taxpayers (i.e. tax increases for businesses at less than the inflation rate, tax increases for residents at more than the inflation rate). Future tax increases for businesses are projected by the City at an average of only 0.17 percent per year (equivalent to about $2 million in City revenue). Effectively, the City is not relying on business property taxes for significant revenue growth.

- So far as economic efficiency is concerned, the key limitation of the City's policy framework is not over-reliance on business property taxes for revenue growth. Rather, the limitation arises from the manner of arriving at the 0.17 percent projection: inter-action of policy measures tending to increase or decrease business property tax rates. This approach sends mixed signals to investors, making future tax rates less certain and thus limiting positive investment impacts.

- Adding to the uncertainty, the City of Toronto Act 2005 leaves the ultimate result to future regulations. Clarifying signals to the market would optimize results of the City's policy framework, at potentially minimal cost in foregone revenue. (The cost would result from 0.17 percent becoming a maximum increase rather than an average, with this cost increasing by about $2 million / year if zero percent became the maximum.)

ADDENDUM: UPLOADING FROM MUNICIPALITIES TO ONTARIO

A recent newspaper column discussed the Conservative Party platform commitment to address fiscal imbalance:

"…in a mid-campaign letter to Alberta Premier Ralph Klein, (Stephen) Harper said he would consider 'transferring tax points to the provinces'. This means that the federal government would lower its taxes and invite the provinces to raise theirs by a corresponding amount. Such a move could be hugely beneficial to Ontario and render all of the federal Liberals' ad hoc deals relatively insignificant."[2]

It is noted that tax points would be considered as a fiscal imbalance remedy, not that they are necessarily favoured at this point. Where basic fiscal reforms are pending, there is an expectation that all options will be carefully examined. A federal upload of social assistance and social housing costs, as suggested in this

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[2] Ian Urquhart "So Will Harper be Good for the Province or Bad?" Toronto Star Jan. 21, 2006, p. F5.

report, would have a strong public policy rationale. It would also be “hugely beneficial” to Ontario, removing $4 billion / year from provincial expenditures and $2.2 billion / year from municipal expenditures.

Still, the new federal government may lean philosophically toward a reduced federal role. That inclination may make tax points the preferred remedy for fiscal imbalance. If new Ontario revenues from this source are “hugely beneficial”, municipal social assistance and social housing costs would – in all likelihood – be uploaded to the Province.

The Ontario government does not defend municipal responsibility for social assistance / social housing, at least not on a public policy basis. Instead, it points to its own fiscal circumstances as the barrier to uploading. In turn, these fiscal circumstances are the product of a well-publicised “$23 billion gap” – a gap between federal spending in Ontario and federal revenue raised in Ontario. With a hugely beneficial change to Ontario’s fiscal circumstances, the barrier to uploading would be cleared away.

Prospects for uploading become less certain if Ontario’s tax-point gains are less than hugely beneficial. The provincial government might say that while progress has been made, it was not enough to permit an upload from municipalities.

The uncertainty could be reduced, however, if the federal government made uploading within Ontario an objective. This would not necessarily mean widening the definition of fiscal imbalance to include municipalities – a widening many would welcome but inconsistent with a strict federal-provincial focus. Instead, the issue could be framed as a provincial issue: revenues financing provinces’ social programs should be appropriate for that purpose; local property taxes do not qualify. When judgement is ultimately rendered on the new federal government’s fiscal imbalance initiative, ongoing use of local property taxes for social programs would indicate failure: a symptom of fiscal imbalance festering on.

By the same token, terminating this unique-to-Ontario financing scheme would be a tangible indicator of progress, even if not all the progress Ontario would like. Among indicators of progress on fiscal imbalance, uploading social assistance and social housing costs would have landmark status. Once accomplished, the upload is unlikely to be reversed.

Alternative indicators, such as increased provincial spending or provincial tax reductions – even provincial deficit elimination – are year-to-year. They could be perceived primarily as provincial accomplishments rather than joint federal-provincial accomplishments. These considerations might motivate the federal government to make uploading within Ontario an objective: an objective the Ontario government could still find acceptable – indeed, perhaps better than acceptable.

Ontario municipalities have long urged the Province to upload social assistance and social housing costs, strongly supported by public finance experts. So far their efforts have been in vain. The new federal government's platform commitment, even though aimed at federal-provincial relations, could present a break-through opportunity for municipalities. Among options for meeting the platform commitment, the federal upload proposed in this report is the only option guaranteeing the municipalities' long-sought goal. However, as this Addendum has indicated, there could be other ways of reaching that goal.

So far as the GTA tax gap and the City of Toronto budget are concerned, an upload is an upload. If $500 million / year can be uploaded from Toronto's cost base, the municipal tax gap can be largely eliminated. Whether the upload is to Queen's Park or Ottawa is secondary. Most attention has been focused on Queen's Park but the Ottawa scenario is worthy of consideration. It is hoped that others will give it that consideration, particularly the advisory panel referred to in Recommendation 1 and – of course – the new government in Ottawa.