

1. Property Taxation in Canada¹

Canada is a federation with three levels of government: the federal government, provincial and territorial governments, and local governments. In the urban parts of the country, there are often two levels of local government: an upper tier (county or regional government) and a lower tier (local government). There are also school boards. Generally, the lower tier is responsible for tax billing and collection on behalf of itself, the upper tier, and the school boards within its jurisdiction.

Under the Constitution, municipalities are creatures of the provincial government. The Provinces can create or destroy municipalities, determine what they can make expenditures on, and what sources of revenue are available to them. In terms of the property tax, the provincial governments set the rules for how the tax base and tax rates are determined. Municipalities in all provinces levy property taxes to finance municipal services. In some provinces, the provincial government also levies a property tax to finance some of the costs of elementary and secondary education.

Provincial control over the tax means that there are similarities in the application of the property tax among municipalities within each province but variations across provinces. For this reason, this discussion on property taxes in Canada will focus largely on one province – Ontario. This is the largest province in Canada with a population of 10.5 million and 4.2 million properties. Ontario has recently undergone a major reform of the property tax. This reform has been part of an overall reform of local government in Ontario that included municipal government restructuring (the number of municipalities in Ontario has been reduced from over 800 to about 500 since 1996) and a realignment of services between the provincial and municipal governments.

Revenue Importance

In Canada, property taxes are levied by provincial and municipal governments. They represent only a small portion of provincial revenues but they are the largest source of revenue to municipal governments. As Table 1 shows, the property tax accounted for over 53 percent of local government revenues on average across Canada in 2000. Furthermore, reliance on property taxes has increased from 48.6 percent of total revenues in 1988. This increase is largely the consequence of a reduction in provincial grants to municipalities over the same period.

Tax Base

In all provinces, the base for the property tax is “real property,” defined as land and improvements to the land. There is different treatment of machinery and equipment in different provinces; in some cases, machinery and equipment “affixed” to real property is included and in

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others it is not. There is also different treatment of minerals, mines, oil and gas wells, pipelines, railways, and public-utility distribution systems in different jurisdictions.

Table 1: Distribution of Municipal Revenue Sources, Canada, 1988 and 2000

Revenue Source	1988	2000
Property Taxes	48.6	53.3
Other Taxes	1.4	1.3
User Fees	20.0	21.3
Investment Income	6.0	5.0
Other	1.1	1.2
Total Own-Source Revenue	77.1	82.1
Unconditional Grants	5.8	2.7
Conditional Grants	17.1	15.2
Total Grants	22.9	17.9
Total Revenue	100.0	100.0

Source: Calculated from Statistics Canada data, Financial Management Systems (FMS), mimeograph, August 2001. 2000 data are estimates.

All provinces assess properties at some percentage of market value (sometimes referred to as actual, real, fair, or current value). In most provinces, farm properties are favoured in the assessment system. Generally, alternative uses of the land are excluded in considering its assessed value.

In Ontario, properties are assessed at their “current value” which is defined as the amount of money the fee simple, if unencumbered, would realize if sold at arm's length by a willing seller to a willing buyer. For farms, conservation lands, and managed forests, value in current use (not highest and best use) is used. Railway and hydro rights-of-way are taxed on a rate per acre for nine geographic regions across the province. The rates are set by provincial statute.

The date used to determine current value is the same for all municipalities across the province. For 2001 and 2002, values will be determined as of June 30, 1999. For 2003 values will be determined as of June 30, 2001. By 2004, current values will be determined each year as of June 30th of the preceding year. Starting in 2005, assessments will be based on average values from successive tax years (referred to as “rolling averages”). For 2005, a two-year average will be employed (a property’s assessment will be the average of the current value for the tax year plus the current value for the previous tax year). For 2006 and subsequent years, property assessments will be based on three-year averages.

Exemptions include churches, cemeteries, Indian lands, public hospitals, charitable institutions, and educational institutions. Land or property belonging to the federal, provincial or local governments is not liable for taxation. Instead of paying property taxes, governments make payments in lieu of property taxes to municipalities. The payments are viewed as property taxes

since the municipality would have collected property taxes on these properties if they were privately owned. They are generally less than the property taxes would be, however.

Tax Rates

Property tax rates are generally determined by the amount of property tax revenue that municipalities need to collect (determined by expenditures less non-tax revenues) divided by the assessment base. In most provinces, there is either a differential tax rate between residential and non-residential properties or a classified assessment system which favours residential properties.

Municipalities in Ontario are allowed to levy variable tax rates for different classes of property. The seven main classes of property are: residential, multi-residential, commercial, industrial, pipelines, farms, and managed forests. Optional classes which municipalities in Ontario can choose include: new multi-residential, office building, shopping centers, parking lots, professional sports facilities, and large industrial. Sub-classes to which rate reductions apply are: vacant commercial (35 percent reduction), vacant industrial (30 percent reduction), farmland pending development, and certain theatres in the City of Toronto. Furthermore, the commercial class can be divided into three sub-classes according to value with graduated tax rates applied to each sub-class. The tax rate on farms and managed forests is legislated to be 25 percent of the residential tax rate.

As noted above, farmland is assessed at its value in current use and the tax rate is legislated to be 25 percent of the residential rate. Tax rates on farmland pending development can be phased in over stages. The triggers for tax increases are: when the land is used solely for farm purposes but has been registered for subdivision and when the land is used solely for farm purposes but a building permit has been issued.

Variable tax rates permit municipalities to shift tax burdens among property classes within provincially-determined ranges of fairness. Transition ratios were calculated for each property class to reflect the relative distribution of burden by tax class prior to reform (the "starting point"). Transition ratios were calculated as the effective tax rate (property taxes relative to market value assessment) for each property class relative to the residential class. The transition ratio for residential properties -- the benchmark -- was set equal to 1.00.

Ranges of fairness were set by the provincial government as in Table 2:

Table 2: Provincial Ranges of Fairness, Ontario

Property Class	Allowable Range of Fairness
Multi-residential	1.0 - 1.1
New multi-residential	1.0 - 1.1
Commercial	0.6 - 1.1
Office building	0.6 - 1.1
Shopping centre	0.6 - 1.1
Parking lots and vacant land	0.6 - 1.1
Professional sports facility	0.001 - 1.1
Industrial	0.6 - 1.1

Large industrial	0.6 – 1.1
Pipelines	0.6 – 0.7

Municipalities can set their tax ratios so as to maintain the transition ratios, move towards the range of fairness, or vary tax ratios within ranges of fairness. For example, if the transition ratio on multi-residential properties was 4.1, a municipality could reduce it to 4.0 or below, or it could maintain it at 4.1. It could not increase it to 4.2 or beyond. In short, municipalities are not allowed to worsen the inequities but they can maintain or reduce them.

Municipal levy increases (i.e., a year-over-year municipal tax increases) are not permitted on a property class if a municipality's tax ratio for the class exceeds the prescribed threshold ratio. The following threshold ratios (where thresholds represent provincial averages) have been prescribed: commercial --1.98; industrial -- 2.63; and multi-residential -- 2.74. Essentially this means that, for those municipalities over the threshold levels for all three property classes, all tax increases resulting from budgetary increases have to be borne by residential property taxpayers.

Tax Relief

Some form of property tax relief is provided in most provinces. Direct property tax relief is provided through three types of programs -- tax deferrals, property tax credits, and direct grants or subsidies. Tax deferrals are administered by provincial and local governments across Canada. Generally tax deferral schemes are only available to seniors, and widowed and disabled taxpayers. Under a tax deferral scheme, the owner of the property is permitted to defer a portion of the property taxes, usually up to a maximum specified amount. This amount is recovered either by the province or the municipality depending on the program. The outstanding amount becomes a lien on the property, payable to the province or municipality, when the ownership is transferred. Sometimes a market rate of interest is applied to the deferred amount; sometimes a lower rate of interest is charged.

Property tax credits are refundable tax credits for homeowners and/or renters administered through the provincial income tax system. A credit for property taxes is applied against a property taxpayer's provincial tax liability. It is generally calculated as a portion of property taxes paid (or a percentage of rent in the case of renters) less some percentage of income. The higher one's income, the lower the property tax credit. Tax credits are generally refundable so that if the property tax liability exceeds income taxes payable, a refund is paid to the taxpayer. Credits for renters and homeowners are used in Manitoba, Ontario, and Quebec.

Grants or subsidies are direct payments from provincial or municipal governments to reduce the burden of the residential property tax. The grant is paid directly to the taxpayer so that the property tax payable is reduced. Grants to residential taxpayers are paid in British Columbia, Alberta, Manitoba, and New Brunswick.

Tax Administration

Municipalities are responsible for the administration of the property tax system in most provinces, including billing and collection. In Ontario, municipalities are also responsible for billing and collecting education taxes (but the tax rate for education is set by the provincial government). The revenues generated by the education portion of the property tax are collected by municipalities and remitted quarterly to their local school boards.

Throughout Canada, assessment is performed by a provincial department or authority. In Ontario until January, 1999, regional assessors (provincial officials) were responsible for preparing an assessment roll. Since 1999, preparing the assessment roll has become the responsibility of the Ontario Property Assessment Corporation (OPAC), a non-profit corporation representing Ontario's municipalities. It was renamed in the Municipal Property Assessment Corporation (MPAC) in 2001 to reflect its large municipal representation. The responsibilities of MPAC include: the determination of assessed values of properties, classification of properties, determination of properties that are entitled to be exempt, preparation of an annual assessment roll and delivery of the roll to municipalities, and defense of assessment appeals.

The Process

The first element in levying a property tax is to identify the property that is being taxed. There have been two systems for people to register interests in land in Ontario.² Under the registry system, any person can register a document pertaining to title to land in a provincial registry office. Purchasers generally retain a private lawyer to examine all of the registered documents to determine whether a vendor has good and valid title. People can sometimes claim ownership by adverse possession (unchallenged occupation) rather than documents.

Under the land titles system, only the property owner can register a document in a provincial registry office, with the approval of a provincial official. This system is therefore a registry of titles, rather than deeds and instruments. If an owner wishes to divide land, such as by plan of subdivision or condominium, the land must normally be held under land titles. As of 1998, the electronic registration of real estate transactions in the land titles system became mandatory in certain parts of Ontario.

The difference between the two systems has to do with the guarantee of ownership. The Land Titles System provides a guarantee of ownership but the Registry System does not. The latter is only a system of registration of documents. Efforts are underway in Ontario to convert all properties to the Land Titles System.

The assessment roll contains the name of the legal owner, the amount of the assessment, and other variables affecting the assessment. The owner must be notified in writing of any change in the assessment affecting the property.

Residential properties are assessed using computer-assisted mass appraisal (CAMA) as well as traditional appraisal techniques. CAMA is a statistical technique used to analyze data in order to predict the value of one variable (market value) from the known value of other variables (such as

² For a useful earlier overview of cadastral systems in Canada, see P.F. Dale, *Cadastral Surveys within the Commonwealth* (London: HMSO, 1976).

living area, lot size, quality, location etc.). The task is to examine properties that have actually sold and to identify statistical relationships between the features of these properties and their selling prices. These same relationships are then used to estimate the probable price for properties that have not sold. By using this technique, annual assessment updates are possible without a physical inspection of the property.

Taxpayers in all provinces can appeal their assessment to a quasi-judicial body such as the Assessment Review Board in Ontario. If unsuccessful, they can generally appeal to the courts. In terms of collection, tax arrears are fairly low in Canadian jurisdictions. In Ontario in 1999, for example, the ratio of tax arrears to the total property tax levy was just over 7 percent.

Property Tax Reform in Ontario in 1998

This section describes and evaluates a major property tax reform that took place in Ontario in 1998.

The Need for Property Tax Reform

There was consensus that the assessment system in Ontario was broken and needed to be fixed, even though there has not always been consensus on how to fix it. The assessment systems in a number of municipalities in Ontario were seriously out of date. In Toronto (with a population of over 2 million), for example, the last reassessment was in 1953 and assessed values were based on 1940 values.

The result of an out-of date assessment system was three types of inequities: within classes of property; between classes of property; and across municipalities. Within classes of property, for example the single-family home class, older properties were under-assessed relative to newer properties. Between classes of property, residential single-family homes were under-assessed relative to apartments and relative to commercial properties. In Toronto, for example, apartments were assessed more than four times single-family homes of equal value. Across municipalities, similar houses in two municipalities were assessed at different amounts.

These inequities led to a dramatic increase in assessment appeals. A large proportion of the assessment base of Toronto was under appeal each year. To the extent that appeals are successful, the assessment base is eroded. This means that all taxpayers face higher tax rates. The decision on the part of Toronto politicians to favour residential properties by not permitting a reassessment for five decades, combined with a statutory higher tax rate on commercial and industrial properties, meant that taxes on businesses were higher in Toronto than the rest of the region. This differential provided an incentive for businesses to leave Toronto. For these two reasons, reform became urgent.

The change to a uniform province-wide assessment system by itself would have resulted in large shifts in tax burdens within and between classes of property. For this reason, tax policy changes were introduced at the same time. Prior to the reform, municipalities were required by

legislation to levy differential tax rates on residential and non-residential property. Specifically, the residential rate had to be equal to 85 percent of the non-residential rate. The Province moved to the variable rate system described above.

In addition to variable tax rates, the Province legislated phase-in provisions and tax deferrals to address the shifts that would occur within classes of property, especially within the residential property class. Municipalities, at their option, could apply a phase-in for up to 8 years for assessment-related tax changes. Interclass subsidization is not permitted. Tax decreases in the commercial class, for example, cannot be used to subsidize tax increases in the residential class. Different schemes can apply to different classes; different phase-in periods can be used for decreases and increases.

Further Tax Policy Reforms

Even with the initial tax policy reforms and phase-in mechanisms, there were still large shifts in tax burdens. In particular, the tax burden on small retail commercial properties increased relative to large office towers because of the recession in office markets in June 1996 (the valuation date). To reduce the shift onto small commercial properties, the provincial government introduced optional classes for office towers, shopping centres, and parking lots. It also introduced optional capping. Municipalities could limit tax increases on commercial, industrial, and multi-residential properties to 2.5 percent a year for 3 years (1998, 1999, 2000). This meant that the property tax could not increase more than 2.5 percent on any of these properties over what it was prior to reform. Furthermore, any tax increases over the 3-year period resulting from increased expenditures, for example, would have to be financed from the residential property class.

Only Toronto chose the capping option initially. When it became clear that there were large tax increases on small commercial properties in other municipalities in Ontario, the provincial government introduced another piece of legislation which restricted property tax increases on commercial and industrial properties to 10 percent in 1998, an additional 5 percent in 1999 and an additional 5 percent in 2000. This legislation was not optional but municipalities could decide how to achieve the 10-5-5 target -- through phase-ins, capping or some other method.

The result of capping was to freeze the assessment roll based on 1997. In other words, the new assessment roll was not being used for multi-residential, commercial, or industrial properties. Capping also meant that there was no effort to remove or even reduce the inequities in property tax burdens within the commercial, industrial, and multi-residential property classes.

For 2001 and subsequent years, municipalities are required to limit the assessment-related property tax increases on commercial, industrial, and multi-residential properties to 5 percent per year. A frozen assessment listing is no longer required for the administration of the new 5 percent limit.

Evaluation of Assessment and Property Tax Reform

Seven pieces of legislation were needed to reform the property tax in Ontario. The result is a tax system that has not changed much in terms of equity but has changed dramatically in terms of the complexity of administration and degree of provincial control. Current value assessment is being used for residential properties. The assessment on multi-residential, commercial, and industrial properties, however, has virtually been frozen at pre-reform levels. By focussing on tax stability for each tax class, one of the initial goals of the reform -- to create a property tax system that is fair -- was lost completely. Fairness has not been achieved because inequities between classes of property have not been eliminated and the inequities within the classes (other than residential) have also not been reduced.

Although the assessment function has been downloaded to a corporation comprising mostly municipal officials, the tax setting process is largely being controlled by the provincial government. Although municipalities have control over the level of taxes, their control over the distribution of taxes among classes of property has been severely constrained by the Province.

There are some lessons that can be learned from the reform of property taxation in Ontario. First, the longer you wait to reform the tax, the more difficult it will be. Annual reassessments for property tax purposes will create far fewer shifts in taxes than a reassessment after 30 years. Second, taxpayers need to have confidence in the assessed values and the process used to derive them. This means taking the time to do the assessment properly.³ Third, the degree of uniformity in assessment is generally higher when assessment is a provincial function rather than a local function.⁴ Although it is too early to evaluate whether there is a lesson to be learned in Ontario, moving the assessment function from a provincial department to a corporation subject to greater municipal control may in time raise questions about the potential to ensure uniformity. Fourth, it is preferable to understand the impact of a reassessment and design appropriate tax policy before implementing property tax reform rather than to undertake the reassessment and then design tax policy in a piecemeal fashion in response to taxpayer resistance. Fifth, as part of the tax policy design, phase-ins and tax deferrals are essential.

More generally, the lesson from the Ontario experience is that, no matter how economically desirable the long run outcome of any policy change may be, its transitional effects may be sufficiently undesirable in political terms to kill it. From a public choice perspective, the losers from a change in policy tend to be very vocal (even if they are the minority) because they value their losses more than the gainers (even if they are the majority) value their gains. This problem is not unique to property taxes but it is particularly significant because of the visibility of this tax.

Other Taxes on Land

³ In another Canadian province (British Columbia), market value assessment was introduced in 1978, four years after the Assessment Authority was created. Over the four year phase-in period, the Authority kept two rolls (a phase-in roll and a market value roll). This allowed time to prepare the market value and conduct impact studies. The first market value roll was not released to the public until 1978.

⁴ Studies in the United States suggest that the degree of uniformity in assessment is higher when county assessors (rather than local assessors) are used and when the state government establishes and enforces assessment standards.

Other taxes on land include special assessments, land transfer taxes, and development charges.

Special assessments

Special assessments (also known as local improvement charges) are compulsory charges imposed on residential, commercial, and industrial properties to pay for additions or improvements to existing capital facilities that border on those properties. They are used for capital expenditures to pave or repave streets, install or replace water mains or sewers, construct sidewalks, install street lighting, etc. The municipality constructs the works and then recoups the cost through a special assessment on the properties that directly benefit from the government expenditure. Although the magnitude of the charge is based on a particular capital expenditure in a particular year, the costs may be spread over a period of years.

The most common base for special assessments is the front footage of those properties that abut the capital works in question but the charges can also be levied on the basis of size of lot, assessed value of property, or by zone.

Land transfer taxes

Land transfer taxes are levied at the time of sale of a property and are calculated as a percentage of the value of the property transferred. The tax, which must be paid before the transfer will be registered, is like a sales tax payable by the purchaser and calculated as a percentage of the purchase price. The tax rate sometimes increases with the value of the property; in some cases, taxes are higher on non-residents.

In Ontario, for example, the rate is 0.5 percent of the first \$55,000 of purchase price; 1 percent on the amount from \$55,000 to \$250,000; 1.5 percent on the amount from \$250,000 to \$400,000; and 2 percent on the amount over \$400,000. A refund is provided for first-time homebuyers of newly built homes which applies to the entire tax payable up to a maximum of \$2,000. The refund is calculated according to the amount of financial interest the purchaser has in the home. In British Columbia, the tax is 1 percent on the first \$200,000 of purchase price and 2 percent on the amount over \$200,000. Similar schemes exist in other provinces.

Development charges

Development charges (also known as exactions and lot levies) are levied by local governments on developers to cover the growth-related capital costs associated with new development (or, in some cases, redevelopment). These charges provide revenues from the private sector to municipalities to finance infrastructure needs arising from growth. Development charges are

levied for officially mandated programs and the funds collected have to be used to pay for the infrastructure made necessary by the development.⁵

Development charges are structured according to a set of rules. Local governments in Ontario, for example, are required to calculate the need for the services to be financed by development charges, where the need for services depends on the forecasted growth over the next ten-year period and the existence of excess capacity. Future capital expenditures have to be specified by category of expenditure and a determination made of what portion is growth-related. The calculation of the development charge cannot be based on a level of service that exceeds the average level of service provided in the municipality over the last ten years.⁶

Although the charge can be levied on a uniform basis across a municipality or on a development by development basis, most municipalities in Ontario levy a uniform charge. Municipalities in British Columbia, however, favour a development-by-development approach.

Other exactions (formal or informal) on the developer that are part of the subdivision approval process include, for example, land dedications that require the developer to set aside land for roadways, other public works, school sites, or for environmental reasons; parkland dedications that require a portion of the land used for development to be set aside for parkland or that a cash payment in lieu of parkland be made; density bonusing whereby developers are granted higher densities than are permitted by planning regulations in return for meeting conditions such as providing day care, preserving an historic building etc., connection fees to permit developers to buy into existing capacity of water and sewer facilities; and over-sizing provisions (sometimes called front-end financing) that require developers to provide more infrastructure than is required for their development. The municipality, in some cases, agrees to recover part of the costs on behalf of the developer from future benefitting owners.

Sources:

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Slack, Enid. 2001. "Property Taxation" Freire, Mila and Richard Stren, *The Challenge of Urban Government: Policies and Practices*. Washington, D.C: The World Bank Institute, pp. 269-79.

⁵ Municipalities in Canada have, historically, required developers to provide or pay for on-site services such as streets, street lighting, sidewalks, and other public facilities within the subdivision. More recently, municipalities have extended the responsibility to developers to pay for the off-site costs associated with new development. Although most municipalities specify the on-site costs that are required to be made by developers, not all municipalities make developers pay for the off-site costs. Development charges only apply to the off-site costs.

⁶ The estimated capital costs have to be reduced by an amount that reflects a municipality's excess capacity and by an amount that reflects the benefit to existing development. Furthermore, legislation requires that the capital costs be reduced by 10 percent for infrastructure other than water supply, waste water, storm water drainage, services related to highways and electrical power, police and fire protection services.

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