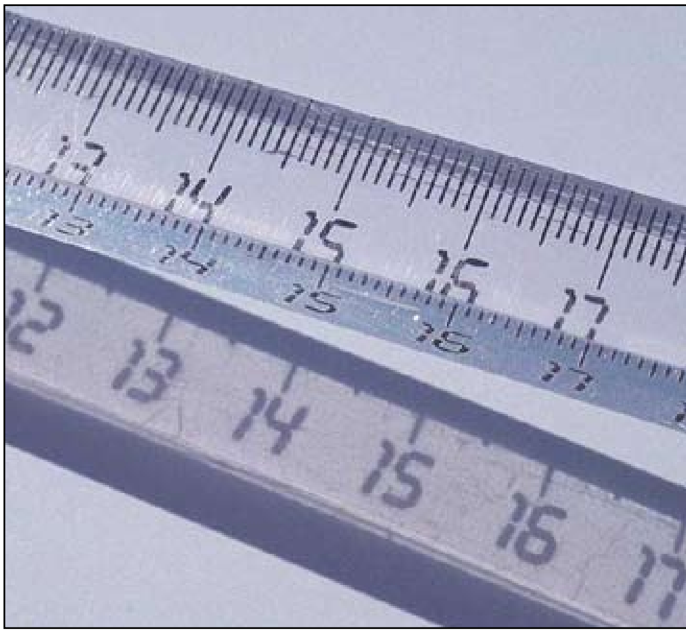

Problematic Property Tax

Why the Property Tax Fails to Measure Up and What to Do About It

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Western Cities Project

Seizing the opportunities, and effectively addressing the challenges, facing Canada's big cities is critical to both economic prosperity and quality of life in Canada. The Canada West Foundation's *Western Cities Project* has been providing timely and accessible information about urban issues since 2000. The project is focused on six western Canadian urban areas – Vancouver, Edmonton, Calgary, Saskatoon, Regina, and Winnipeg – but it speaks to issues that affect urban areas across Canada.

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EXECUTIVE SUMMARY

Introduction

Property tax debates have raged for years. On one side of the street are those who complain that property taxes are too high and the tax burden is growing too rapidly. On the other side of the street stands the municipal administration who responds that property tax revenue does not always grow alongside the economy and incremental increases are needed. Standing in the middle of the street are mayors and councillors confronted with the nasty choice of "raising" taxes or "cutting" services. Given the perennial nature of the property tax debate, the Canada West Foundation has issued this position paper. The paper examines the property tax from a number of different vantage points.

Position

The property tax is the only substantial tax available for local governments in Canada, and critics of the tax are right when they claim it alone is insufficient to meet the needs of today's large modern cities. Defenders of the tax are wrong in asserting that the property tax is the only way – or even the best way – to fund all of our varied civic endeavours. What is more, property taxes across the local government sector are not out of control, and the same can be said for property taxes in most large western Canadian cities as well. In fact, property taxes are currently at some of the lowest levels seen in the past 45 years despite claims to the contrary. The property tax may have served our cities well in the past but it is no longer up to the task. For a variety of reasons – and for better or worse – the property tax will continue to form a key part of the municipal revenue mix. But our cities should not be so singularly reliant and heavily dependent on this one tax source. The amount of property tax collected in our cities should be reduced and the gap filled with different tax options.

Essential Data

For each additional dollar paid in tax since 1961, roughly 60¢ has come in the form of more federal and provincial personal income tax and premiums paid to federal and provincial social programs. Another 25¢ has come in the form of additional federal and provincial sales tax. An additional 10¢ has come in the form of corporate income tax and miscellaneous federal and provincial taxes. Only about 5¢ out of every additional tax dollar paid since 1961 has come in the form of local government taxation.

In 2007, local government taxes in Canada were 8.9% of all taxes collected. This is much lower than the 16.7% recorded in 1961. Over the 1961-2007 period, local taxes grew, on average, by 1.7% annually when adjusted for population and inflation. This is one of the lowest growth rates of any tax used by any government in Canada. For example, provincial personal income tax averaged 10.2% annual growth in real per capita terms over the same time period.

Setting municipal property tax against personal disposable incomes is an important measure of the tax burden, because it is out of this income that the tax has to be paid. An analysis of property taxes in Vancouver, Edmonton, Calgary, Saskatoon, Regina, and Winnipeg show that municipal property taxes in 2007 are at their lowest level relative to personal disposable income since 1990. Municipal property tax has also dwindled relative to each city's per capita share of provincial GDP. In fact, if property taxes had kept pace with provincial GDP growth, the six cities would have collected $1.3 billion more in property tax in 2007 alone.

Strengths and Weaknesses

Historical acceptance, an immobile and stable tax base, reliable and predictable revenues, and high visibility are often cited as positive features of the property tax. But on closer inspection, many of these advantages are not as clear and plain as many suppose. Further, the property tax carries numerous inherent disadvantages, such as a tax base that tends to expand slowly and revenue that fails to keep pace with economic and population growth. Of particular concern is the way in which the property tax is currently administered and applied. Serious equity concerns are emerging. This hits on the efficiency of the tax and is negatively affecting the degree of accountability taxpayers can expect from the tax.

Conclusion

Property tax reform is a logical starting point in terms of a policy response, but this may not be possible given the current political dynamic in most cities. Even with fundamental reform, the inherent disadvantages of the tax will remain. The challenge and opportunity is to find a way forward by employing a broader range of tax tools that can supplement the property tax. This reflects the larger international experience of cities that use a wide variety of tax mechanisms to finance local services and infrastructure. ■

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INTRODUCTION

Whether one lives in a large metropolitan centre, a medium-sized city, a small town, or even the rural countryside, property taxes are often one of the hottest local issues of the day. On one side of the street stand residents and business owners who complain that property taxes are too high and the property tax burden is growing too rapidly. On the other side of the street stands the municipal administration responsible for delivering local services. They understand that property tax revenue does not always grow alongside the broader economy and incremental increases are sometimes required to cover the costs of inflation, accommodate a growing population, and simply maintain service levels never mind increasing overall revenue in real terms. Standing smack dab in the middle of the street like deer caught in the headlights – dare we say crossfire – are mayors and city councillors confronted with making the nasty choice of "raising taxes" to maintain services and infrastructure or pursuing a "zero-percent" property tax increase while finding ways to trim civic expenditure or even cut local services.

The larger public policy community has long traded shots across this street as well. The concern here is not narrowly restricted to whether property taxes are too high or too low. The concern is more fundamental in nature and involves the relative merits of the property tax, its appropriateness as a funding mechanism, and whether it alone can continue carrying the load of financing large cities that are increasingly dominating the demographic, political, economic, and social landscape. There is precious little agreement:

> *"If any tax could have been eliminated by adverse criticism, the general property tax should have been eliminated long ago. One searches in vain for one of its friends to defend it intelligently. Should some prosecuting attorney drag the tax as a culprit before a bar of justice, he would be embarrassed by the abundance of expert evidence against it. Yet, the tax persists."*
>
> *– Jens P. Jensen (Jensen 1931)*

> *"Generally, a good local revenue system would generate a revenue stream that is relatively productive and stable over time, neutral with regard to its impact on private economic decisions, is simple and predictable, and is equitable. Relative to other potential sources of local tax revenues, a local property tax scores well on all of these criteria."*
>
> *– Michael E. Bell (Bell 1999)*

> *"The bottom line on this issue is that people hate the property tax and have hated it forever. Everybody believes the property tax is horrible, except for a small minority of the population. At the end of the day, however, the property tax is the best tax to fund local government."*
>
> *– David Brunori (Fritze 2008)*

> *"Property taxes have been studied for a rather long time. The discussion can be traced back at least to the mid-19th century. Most strikingly, however, despite the large number of articles and despite all the years of debate there is still a remarkable lack of agreement on fundamental issues regarding the property tax."*
>
> *– Svante Mandell (Mandell 2001)*

> *"Whether the property tax is a good tax is, of course, a matter for debate."*
>
> *– D.J. Sherbaniuk (Sherbaniuk 1976)*

POSITION

Those familiar with the work and emphasis of the Canada West Foundation are aware of our goal to serve as a source of strategic insight into western Canada and to act as a catalyst for informed and meaningful debate on the important policy issues of our day. In fulfilling this mission, the Foundation conducts research, offers in-depth analysis and discussion of the policy implications of that research, and identifies the various options and alternatives from which public decision-makers can choose. Seldom do Foundation policy analysts stake out a position and then proceed to prove or defend that position.

This paper – a position paper – is different. This analyst has landed with his feet firmly planted on one side of the public policy street. The property tax is the only substantial tax available for local governments in Canada, and critics of the tax are right when they claim it alone is insufficient to meet the needs of today's large modern cities. Defenders of the tax are wrong in asserting that the property tax is the only way – or even the best way – to fund all of our varied civic endeavours. What is more, property taxes across the local government sector are not out of control, and the same can be said for property taxes in most large western Canadian cities as well. In fact, property taxes are currently at some of the lowest levels seen in the past 45 years despite claims to the contrary. The property tax may have served our cities well in the past but it is no longer up to the task. It is the position of this analyst that the property tax alone is incapable of building a strong fiscal future for our cities.

Should the property tax be ditched completely? No. From an economic perspective, such an approach would be undesirable. From a political perspective, it amounts to fat chance. For a variety of reasons – and for better or worse – the property tax will always form a key part of the municipal revenue mix and it should remain as the foundational local tax source. The point here is that our cities should not be so singularly reliant and heavily dependent on this one tax source. In arguing the point, this paper will present a polemic that runs in two directions. The property tax stands in need of fundamental reform, but this may not be possible. For this reason, the amount of property tax collected in our cities should be reduced and the gap filled with different local tax and tax revenue sharing options.

OUTLINE OF THE PAPER

Understanding the rationale behind this position and the prescription for a better way forward are the warp and woof of this paper. The paper works to answer a number of questions:

- *Introductory Context:* What is a tax? Why do governments tax? What are the different types of taxes? How do they work? Where does the property tax fit in the larger pantheon of taxes?

- *Property Tax Basics:* What is a property tax? How does it work? What are the various forms of property taxation?

- *The Tax Burden:* What is the relative burden of the property tax compared to other taxes? Has this burden changed? How high are property taxes today compared to historical levels?

- *Performance Criteria:* What are the objective standards by which a tax can be judged? What makes for a good tax? What makes for a lousy tax? Do some criteria trump other criteria? If so, which ones are conceivably more important?

- *Property Tax Evaluation:* How does the property tax stack up against these objective criteria? What advantages and disadvantages does the property tax bring to the fiscal table?

- *What to Do:* What conclusions can be reached concerning the property tax as a source of local government funding? What essential touch points must drive any serious attempt at property tax reform? Should cities depend less on property taxes? How can a more diverse tax system be brought into play? How can Canada's large cities be made more fiscally sustainable? Most important, how would a more diverse tax mix help?

PROVING THE POINT

The flow of this paper is relatively simple and straightforward, but the individual arguments are more complex. Briefly stated, there are criteria by which any tax can be measured and subsequently judged. Examples of these criteria include efficiency, equity, neutrality, simplicity, and elasticity. When the property tax is set against these criteria, it does not always perform well. To be fair, there are criteria against which the property tax does quite well. But in the final analysis, the property tax cannot be said to score an undisputed and decisive win on any one criteria. In some instances, the property tax fails simply because of the inherent nature of the tax. In other instances, the property tax fails because of the peculiar way it has developed over time and is currently administered. In yet other instances, the property tax at first glance appears to perform well, but closer examination shows things are not as cut and dry as initially thought. When measured against a range of beneficial criteria, the deficiencies of the property tax come out in stunning fashion. As such, it is incumbent that new and more creative alternatives be brought into play for Canada's cities.

INTRODUCTORY CONTEXT

The inevitability of death and taxes is a cliché that continues to resonate. At the same time, the familiar bromide is not always well understood. Why is taxation inevitable? For that matter, how do you define a tax? In setting the context, these two questions are the logical starting point.

The essential defining feature of a tax is how it compels individuals and corporations – under rule of law – to yield a portion of their income or accumulated wealth to government. Unlike voluntary payments for goods purchased or services rendered, taxes are involuntary and paid under threat of coercion. Taxes are levied for two reasons. First, taxes produce revenue that governments use to provide public goods and services and to redistribute income. This purpose is well-recognized and is termed the *revenue effect.* The second purpose – the *allocative effect* – is less obvious but no less important. Whenever something is subjected to tax, governments can both intentionally or unintentionally change the allocation of resources in the economy. Taxes create a disincentive to produce, consume and exchange the things being taxed. The allocative effect works well because like death, taxes are something that citizens generally prefer to avoid.

METHODOLOGY: Data Sources and Caveats

A full exploration of the property tax requires analysis of significant amounts of data. Here, Canada West Foundation researchers employed two data sources. First, a database was constructed detailing all taxes collected by the three orders of government in Canada from 1961-2007 using over 45 years of *National Income and Expenditure Accounts (NIEA)* data published by Statistics Canada. With these data, the various taxes collected can be totalled and the relative burden of each tax measured. Various taxes can also be set against a number of control variables such as population, inflation, personal incomes, and the size of the economy (gross domestic product or GDP) to determine how taxes have increased in real or relative terms.

The system of *National Accounts* is a consistent and reliable source of tax data with a common set of baseline parameters. There are only two cautions to note. First, the database relies on two separate reporting periods with slightly different methodologies (1961-1980 and 1981-2007). While slight variances between the two periods are evident across a number of data points, the overall impact is marginal. Second, the total tax collected by the local government sector includes municipalities as well as other local entities and the tax total is not exclusively comprised of property tax. While more precision in the data would be helpful, it does appear that 90-95% of the local sector tax total is indeed comprised of property tax. Thus, local taxation in the *NIEA* data largely equates to property taxation, but not exclusively so.

Unfortunately, the *NIEA* data do not break-out tax amounts for individual cities, the municipal portion of the local property tax is not always distinguished from the education portion, and detailed tax break-outs for each order of government are not always available for the most recent fiscal years. As such, the NIEA data provide only a macro view of the total taxes collected by various governments. However, we are also concerned with the situation facing six of western Canada's largest cities. As such, Canada West Foundation researchers built a second database for the 1990-2007 period using the *Public Accounts* – annual financial reports and budgets published by individual governments. This effort resulted in detailed tax databases for the federal government, each of the four western provincial governments, and the cities of Vancouver, Edmonton, Calgary, Saskatoon, Regina, and Winnipeg. To uncover how taxes have grown in these six large western cities, a number of control variables were also collected, most notably the personal incomes generated in each of the cities. These data were secured from Revenue Canada's *Income Tax Statistics*.

More caution is in order regarding *Public Accounts* data. Here, governments are generally more free to employ their own accounting methods. Different accounting and presentation styles, changing accounting practices, inconsistent definitions, and significant changes in government operations and consolidation practices occur frequently, and comparable figures are not always restated for prior years. As such, some of these data had to be adjusted. These adjustments were checked against bond rating reports issued by the *Dominion Bond Rating Service (DBRS)* and also against a detailed database produced by the Foundation for an earlier study entitled *Dollars and Sense II: Big City Finances in Western Canada, 1990-2007*. The database that emerged is relatively sound, consistent over time, and forms a reasonable base upon which to draw comparisons and conclusions.

Perhaps the biggest challenge here lies in completely separating out the different types of property taxes collected in the cities. For the most part, the data focus only on property taxes such as the general residential and commercial property tax, local improvement levies, and business occupancy taxes. However, for some cities, other taxes like amusement taxes and miscellaneous tax amounts could not be completely isolated. But like the *NIEA* data, these amounts were generally small. The great bulk of the tax data used is indeed property taxation. For all six cities, the tax amounts exclude revenue-in-lieu of tax and any franchise taxes and fees.

Aside from the data analysis, Canada West Foundation researchers also conducted a literature review in order to pull together the primary arguments both for and against the property tax. Previous Foundation research in this regard was also reviewed and synthesized as well. This includes academic articles, government studies, conference reports, and the results of past interviews with financial directors and officials in each of the various cities.

No question of public policy is more littered with mines and other explosive hazards than the issue of taxation and government spending. Both sides of the fiscal ledger are under continual scrutiny, and this reflects the ongoing preoccupation of the public with the amount of taxes they pay, whether taxes are too low for some, too high for others, or just too high right across the board. Then there is the whole matter of whether or not citizens believe they are receiving good value for the taxes they pay.

While all of these are important considerations, none of them should completely overshadow some more basic questions. How are taxes collected? From whom are they collected? How are taxes being implemented and subsequently administered? In other words, the way a tax system operates and the types of taxes in play are just as important as the total value of the tax revenue collected – if not more so.

Enter the municipal property tax. Where does it fit among the other taxes comprising the larger Canadian tax picture? The answer comes when examining the property tax in its natural habitat. Economists and public finance analysts typically employ a relatively simple taxonomy that places all taxes into one of two broad *categories* – direct taxes and indirect taxes. Both categories can then be divided into several specific *types* of taxes.

1. Direct Taxes

Direct taxes typically possess three features. First, direct taxes always target incomes directly. In other words, some type of income serves as the tax base. Second, direct taxes are usually paid directly to government by the individuals or legal entities on whom the tax is imposed. Third, the incidence of direct taxes remains with the individuals and entities being taxed. In other words, the tax cannot be easily exported or shifted to someone else. Under a direct tax, the individual or entity being taxed carries the tax burden and ultimately pays the tax.

Direct taxes are applied against a broad range of income including personal income, business income, and corporate income. Specific examples here include wages, salaries, commissions, self-employment income, interest income from investments, dividend income from corporations, capital gains, and business and corporate profits. In Canada there are several types of direct taxes.

- *Income taxes:* The first type of direct tax includes *personal income tax* and *corporate income tax* levied by federal and provincial governments. These two taxes comprise the bulk of direct taxation in Canada and are typically employed for general revenue purposes. Various types of *payroll taxes* can also qualify as a direct tax on income, but much depends on how these taxes are structured. A payroll tax calculated as a percentage of a company's total payroll or as a proportion of an employee's pay clearly resembles a direct tax. However, a payroll tax charged at a fixed rate would appear more indirect than direct.

- *Dedicated social taxes:* The second type of direct tax includes tax levies dedicated or earmarked for funding specific federal and provincial social program expenditure. These taxes include *premiums* or *contributions* paid by employers and employees to the Canada and Québec Pension Plans, Employment Insurance, various federal and provincial public employee pension plans, and provincial workers' compensation programs. All of these taxes are usually levied at a certain percentage of income, but only up to a maximum amount.

- *Wealth taxes:* The third type of direct tax includes various *transfer taxes, inheritance taxes, estate taxes,* and *gift taxes.* All of these taxes come into play when the wealth of one individual or legal entity is subsequently transferred to another. The wealth transferred is deemed as income when received by the recipient and is subsequently taxed.

2. Indirect Taxes

Indirect taxation is more complex. First, indirect taxes do not use income as the tax base. While all taxes are ultimately paid out of income, indirect taxes target income indirectly or in a roundabout way. A sales tax, for example, is paid out of the disposable income that remains after direct taxes have been paid, but the actual base of the tax is the value or amount of a good or service purchased. Some forms of indirect taxation have no tax base at all, and simply constitute a fixed charge. Second, many indirect taxes are collected by intermediaries who then turn the proceeds over to government on behalf of the taxpayer. In other words, government is paid indirectly. Third, the potential always exists for indirect taxes to be exported or shifted to others. For example, a sales tax is usually collected and forwarded to government by business. Tax incidence, however, does not rest with the business but with the consumer of the good or service. Like direct taxation, there are several types of indirect taxes.

- *General sales taxes:* A general sales tax targets spending or consumption, and is typically levied on a broad basket of goods and services with few exemptions. Two types of general sales taxes dominate the landscape. The first is a *general retail sales tax (RST)* that focuses primarily on a broad base of goods. These taxes are sometimes called "turnover" or "cascading" taxes because tax is levied on the total value of a good as it moves through each stage of production. The second type of general sales tax is a *value-added tax (VAT).* These taxes apply to both goods and services but business inputs purchased in the production process are exempt. In other words, tax is paid only on the added value of a product as it moves through production. Specific examples of general sales tax in Canada include the value-added federal Goods and Services Tax (GST), provincial retail sales taxes converted into VAT and harmonized with the federal tax (HST), and separate provincial retail sales taxes.

- *Selective sales taxes: Selective sales taxes, excise taxes,* or *user pay taxes* target specific goods and services. Selective sales taxes are usually levied as a percentage of the total price paid (e.g., 5% of a restaurant bill or hotel bill) or as a fixed charge per unit purchased (e.g., 10¢ per each litre of fuel). Selective sales taxes can be levied in lieu of a general tax because a special rate or separate administration is required, or simply levied as a surtax on top of a general sales tax.

There is a dizzying array of selective sales taxes in Canada levied by all three orders of government. They can be loosely grouped into four types. First are *luxury selective sales taxes* that target goods and services such as lodging and accommodations, restaurants, bars, pubs, and luxury vehicles. A second type are various *user pay taxes* levied primarily on transportation, utility, or communications. Specific examples include taxes on gasoline and diesel fuel, vehicle registrations, driver's licenses, car rentals, parking, insurance premiums, electricity, natural gas, telecommunications, and cable TV. A third set of selective sales taxes are *customs tax* and *duties* levied by the federal government on imported goods. A final set of selective sales taxes are colloquially termed *sin taxes.* These taxes target things such as tobacco, alcohol, and gambling.

Selective sales taxes are levied upon a small tax base and therefore generate limited revenue. But for some of these taxes – particularly tobacco, alcohol, and gambling – government is just as interested in discouraging consumption through the allocative effect as they are with the dollars produced through the revenue effect.

- *Wealth taxes:* An indirect wealth tax targets accumulated wealth whether that be savings, investments, or physical assets. One example for corporate entities is the *corporate capital tax* levied against the retained earnings or built-up capital of small, medium, and large corporations. In the US, it has recently been suggested that private nonprofit organizations and institutions with significant endowments be required to pay an *endowment tax.* Public familiarity with the examples above tends to be quite limited, but this is not the case with the most common form of indirect wealth tax – *the property tax.*

- *Other indirect taxes:* There are a whole range of indirect taxes that exist primarily as a fixed but somewhat arbitrary charge collected apart from an identifiable tax base. Common examples include provincial *health care premiums,* some types of *payroll taxes,* and various *licenses, permits, and fees.* A particularly notorious indirect tax is the *poll tax* or *head tax,* which essentially amounts to a tax on existence – persons are charged an amount of tax regardless of income, wealth, or consumption.

The revenue profile of government is not restricted to taxation alone. All governments raise non-tax revenue as well, including *user fees* from the sale of various public goods and services, *interest income* on financial investments, and *resource royalties.* These revenues are not included within the data presented in this paper. Most public finance analysts draw a sharp distinction between taxes and royalties. Taxes are charged against the wealth owned by individuals and corporations, while royalties arise from the rights of ownership over the development of a natural resource.

SUMMARY: All taxes can be broken into one of two broad categories – direct taxes and indirect taxes. Direct taxes always target incomes directly, whether that be personal income or corporate income. Direct taxes target a wide variety of income sources including wages, salaries, commissions, interest income, capital gains, and transfers of wealth. In Canada, only the federal and provincial governments have authority to levy direct taxes. Indirect taxes are paid out of income, but income itself is not the tax base. Indirect taxation targets the consumption of various goods and services, accumulated wealth in the form of savings, investments, and physical assets, or simply constitutes an arbitrary tax payment. It is within this larger tax picture where we find the property tax, which can be described as an indirect tax on wealth.

THE PROPERTY TAX

Before jumping in and assessing the property tax, it is important to understand how the property tax works, the various forms it can take, the burden posed by the tax, and how this burden has changed and evolved over time. These basic considerations are fundamental to the discussion ahead and also help clarify our thinking on property tax issues.

The property tax has a history going back to ancient times. Not only is it one of the oldest known taxes, it is one of the most enduring. Governments on every continent and in most countries employ some variant of property tax. Nomenclature surrounding the property tax does, however, differ. While Canadians simply refer to it as property tax, it is sometimes called realty tax, real estate tax, millage tax, ad valorem tax, or real property tax. Regardless of the label, all property tax systems share a number of important features and tend to function in similar ways. The best way to understand how the tax works is to review some basic terms and features such as the tax base, classes and categories of property, assessment, tax rates, and the various forms of property tax.

- *Tax base:* As already noted, the property tax is an indirect tax imposed on wealth. The wealth being taxed is the value of property owned. Property does, however, come in different forms – land, improvements constructed on the land, and various personal possessions. Most property tax systems target both land and improvements (commonly called a real property tax). But property tax systems can also tax land only (commonly called a land tax or site value taxation). Another option is to tax land, improvements and tangible personal property such as machinery, equipment, and other personal possessions (a comprehensive ad valorem tax.) Property tax in Canada generally focuses on *real property* – land and improvements. Personal property – vehicles, equipment, machinery, inventory – does not tend to contribute substantially to the larger property tax base.

- *Classes and categories of property:* In administering the property tax, various *classes* and *categories* of property are established based upon the primary usage of the property. Property is typically *classified* as residential property or non-residential. Within these two classes are specific *categories.* For example, property in the residential class is often categorized as either single-family residential or multi-family. The non-residential class is divided into several categories as well and can include designations such as major industrial, light industrial, utility, commercial, retail, forestry, farm, mining, and recreational. Systems of property classification differ widely between jurisdictions, typically turning on the degree of specificity by which property is classified. The major divisions in Canadian property tax systems tend to include single-family residential, multi-family residential, industrial, and commercial.

- *Assessment:* The base of the property tax is not simply the *value* of property but the *assessed value* of property. A key component of any property tax system is the process of assessment by which the monetary value of a property is established for purposes of taxation. Three notions of value underlie most assessment systems – rental value, capital value, and market value. Rental value assesses properties based on the annual rent that could be expected whether the property is actually rented or not. Capital value derives a current value based on estimates of annual rental value. Market value – increasingly the method of choice – establishes value based on the amount for which a property would sell in an open market between a willing buyer and seller. Once the basis of assessment has been settled, the portion of assessed value that will be taxed needs to be determined. Some systems tax properties at 100% of assessed value while others employ a system of fractional assessment that sees only a portion of assessed value taxed. A final consideration is who will carry out the assessments. Options include self-assessment or professional assessors employed by the local taxing authority, a separate assessment authority or agency, a provincial department, or an independent third party under contract.

- *Tax rate:* Understanding assessment can be challenging, and so is coming to grips with the terminology surrounding property tax rates. Most tax rates are expressed as a *percent* – the amount of tax per 100 units of value. Property taxes, however, are typically expressed as a *permille* – the amount of tax per 1,000 units of value. Thus, property tax rates are often termed the *mill rate, millage rate, or mill levy*. To calculate the property tax owing, governments multiply the assessed value of a property by the mill rate and then divide the total by 1,000. Thus, a property with an assessed value of $250,000 with a tax rate of 10 mills would have a property tax bill totalling $2,500.

The interplay between property classification, the method of assessment, and the applicable tax rate is what defines a property tax system and separates the system of one jurisdiction from that of another. In the end, however, the end goal is much the same. The property tax raises revenue to fund government expenditure, and the various choices made on classification, assessment, and tax rates divide up the total revenue sought among the various property owners. In other words, classification, assessment, and tax rates combine to produce an *effective tax rate* that distributes the financial burden among the various property owners.

■ *Forms of Property Taxation:* Although taxpayers typically conceive of the property tax as a single monolith, this is seldom the case. A government can and does employ numerous variants of the property tax simultaneously. These types of property tax can be differentiated based on property type, the purpose of the revenue, or who is paying the tax. As far as most western Canadian municipalities are concerned, the property tax comes in six unique variants.

First is the *general municipal property tax* levy on residential and non-residential land and improvements. The general property tax is typically split in two because the effective rate of tax is seldom uniform between the two classes – each is either assessed differently or different mill rates apply. At the same time, all general property tax revenue typically finds its way into the general revenue fund of the municipality.

A second type of property tax is the *general education property tax* that is set by local school authorities or set by the province on behalf of school authorities. This tax is separated into residential and non-residential components as well, and may or may not employ the same assessment as the municipal component. These taxes are collected by the municipality but flow through to local school boards or the province, which in turn distributes them among provincial school authorities.

A third type of property tax levied by many municipalities – but not all – is the *business occupancy tax.* This is an additional property tax or surtax charged to non-residential properties on top of the general property tax they already pay. While the general property tax employs market value assessment, most business occupancy taxes are assessed based on annual rental value. Like general property tax, however, the dollars collected are usually employed for general revenue purposes.

A fourth type of property tax is the *special assessment, local improvement levy, frontage charge,* or *benefit assessment.* These are special property tax surcharges added to the general tax or utility bill of properties that benefit from new or upgraded infrastructure or specialized services unique to a local area. A *frontage charge* distributes the cost based on the width of each property while an *area charge* uses square footage. Special *zone assessments* can also be used, which are a fixed charge applied to all properties or a variable charge that rises or falls depending on proximity to an improvement. There is debate about whether such levies constitute a tax because they are seldom levied against the assessed value of property. Rather, the amount paid equals an approximation of the benefits received. But neither are they a direct user fee. Special assessments are not charged based on direct usage. As such, local improvements are perhaps best described as a user pay or special benefits tax. Oftentimes, the revenue of special assessments is earmarked to repay debt borrowed to finance a capital project.

A fifth type of property tax is *revenue-in-lieu of tax* or *payment-in-lieu of tax.* These amounts are paid to local governments by federal and provincial governments whose properties are exempt from tax (e.g., schools, hospitals, universities) and by private property owners whose properties are unique and do not fit well into the assessment base (e.g., airports, large utility operations). Revenue-in-lieu is often considered tax revenue, but it is not dependent on the mill rate and municipalities cannot always control the amounts received. In many ways, this revenue appears to be more of an unconditional operating grant. As such, our analysis ignores these revenues.

Finally, taxpayers can also be subject to *special property taxes* where the revenue is earmarked for specific municipal purposes. These taxes employ their own mill rate and are used to fund local public libraries, regional municipal governments including transit, water, and sewer systems.

SUMMARY: The property tax is an indirect tax on wealth, with the assessed value of property serving as the proxy to measure relative wealth across all property owners. Administration of the tax can vary widely and it also comes in a number of different forms. In Canada, these various forms of property tax constitute the single largest tax source for local governments – over 90% of all taxes they collect. Other local taxes come in the form of a very small group of selective sales taxes or franchise fees targeted at amusement or entertainment events, hotel occupancy, and the sale of various utility services such as electricity and natural gas.

PROPERTY TAX BURDEN: National NIEA Data

Public complaints about the level of taxation are commonplace. Yet, one wonders if taxpayers understand just how much they pay through different types of taxes, and further, which order of government is responsible for those taxes. Given the ongoing debate about property taxes, a key question concerns where the tax fits relative to all other taxes.

1. Tax Profile

Figure 1 presents a tax profile using Statistics Canada's *National Income and Expenditure Accounts (NIEA)*. In 2007, individuals and corporations in Canada paid $520.3 billion in taxes to all three orders of government. A number of important points emerge from the profile.

- *First, local government taxation is a relatively small portion of total taxes paid:* Less than 9% of the total tax bill accrues to local governments. About 90% of this amount is represented by property taxes, with the remainder being a small group of other taxes and fees. However, municipal governments do not collect this entire amount. The local government sector in Canada is diverse and includes other actors such as local school boards. At least some of the local tax amount is education property taxes levied and collected by local school authorities.

- *Second, federal and provincial governments collect the bulk of taxes in Canada with direct taxation generating the most tax revenue:* In 2007, the federal government collected 50.5% of all taxes while the provinces collected another 40.6%. Well over half of the total tax bill paid by Canadians comes in the form of direct taxation. Federal and provincial personal income taxes comprise 36.9% of the total, dedicated social taxes another 13.2%, and corporate income tax another 11.0%. Taken together, direct federal and provincial taxation constitutes almost two-thirds of all taxes paid.

- *Third, federal and provincial indirect taxation runs a distant second to direct taxation:* Federal and provincial general retail sales taxes, customs and import duties, and selective sales taxes on fuel, tobacco, liquor, hotels, and other goods and services represent 26.4% of all taxes paid. The provinces are twice as dependent on indirect taxation as their federal counterpart – 41.9% of all provincial taxes accrue from indirect taxes compared to 18.6% for the federal government.

An interesting feature of *Figure 1* concerns the change in the total tax profile that has occurred over the last 45 years. Three trends stand out.

- *First, property taxes comprise a much smaller portion of the tax pie today than 45 years ago:* One of the most interesting findings is the significantly small share of local taxation today. In 1961, local taxation represented 16.7% of the total tax bill, with the great majority of that being property taxes. In 2007, local government taxation was only 8.9% of the total tax bill.

- *Second, provincial taxes have come to claim a significantly increased share of total taxation:* In 1961, the provinces collected 20.9% of all taxes in Canada. But with the introduction of public health care and a variety of other federal and provincially funded social programs, an agreement was struck by which the federal government transferred tax points to the provinces as a means to fund these programs. As a result, provincial taxes now lay claim to 40.6% of all taxes levied. Provincial personal income taxes have been responsible for most of this increase, moving from 1.4% of the total tax bill to 14.1% today. Provincial indirect taxes have also played a role, moving from 12.6% of the total tax bill in 1961 to 17.0% in 2007.

- *Third, federal taxes as a proportion of total taxation have slipped:* The federal government has traditionally collected the largest tax share, and this is as true today as in days past. However, the federal share has slipped over the past 45 years. In 1961, the federal government collected 62.4% of all taxes but this has fallen to 50.5% today. Not only has the federal share fallen, but the mix of federal taxes has shifted as well. Federal personal income tax has remained relatively stable as a percentage of the total tax bill – around 22% – but dedicated social taxation has doubled its share, fuelled primarily by the introduction of the Canada Pension Plan (CPP), the enrichment of Employment Insurance (EI), and significant increases in CPP premiums in the late 1990s to ensure the ongoing viability of the public pension plan.

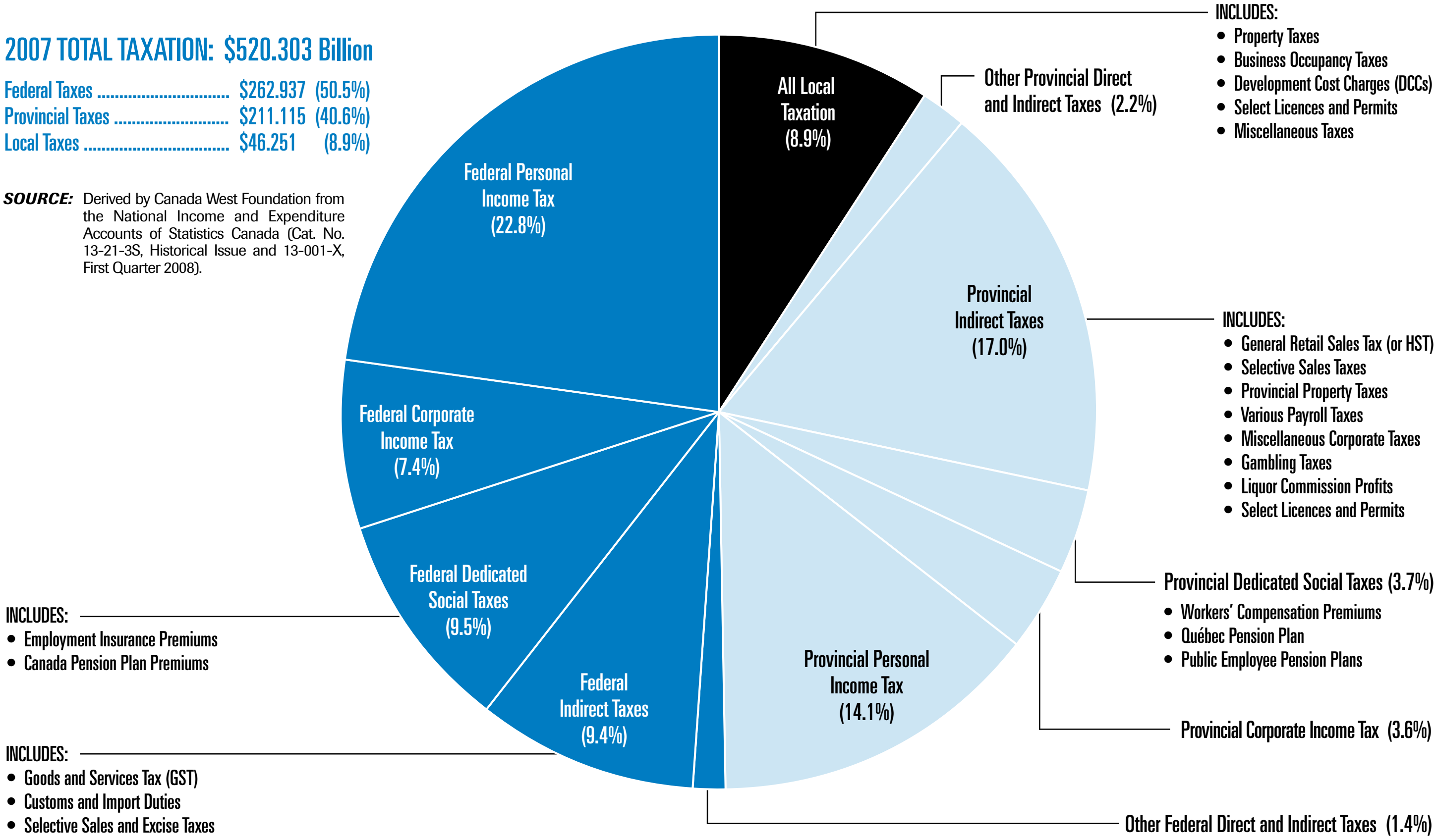
Surprisingly, federal indirect taxes have become much less important to the overall tax mix. This has occurred despite the introduction of the federal Goods and Services Tax (GST) that replaced the Federal Manufacturer's Sales Tax (FMST) in 1990. In 1961, federal indirect taxes represented 21.7% of all taxes collected. That has since fallen to 9.4%. The share of total taxation claimed by federal corporate income tax has also fallen, moving from 13.3% in 1961 to 7.4% in 2007.

FIGURE 1: Federal, Provincial, and Local Taxes in Canada
(2007 and 1961 in Nominal $ Billions)

2007 TOTAL TAXATION: $520.303 Billion

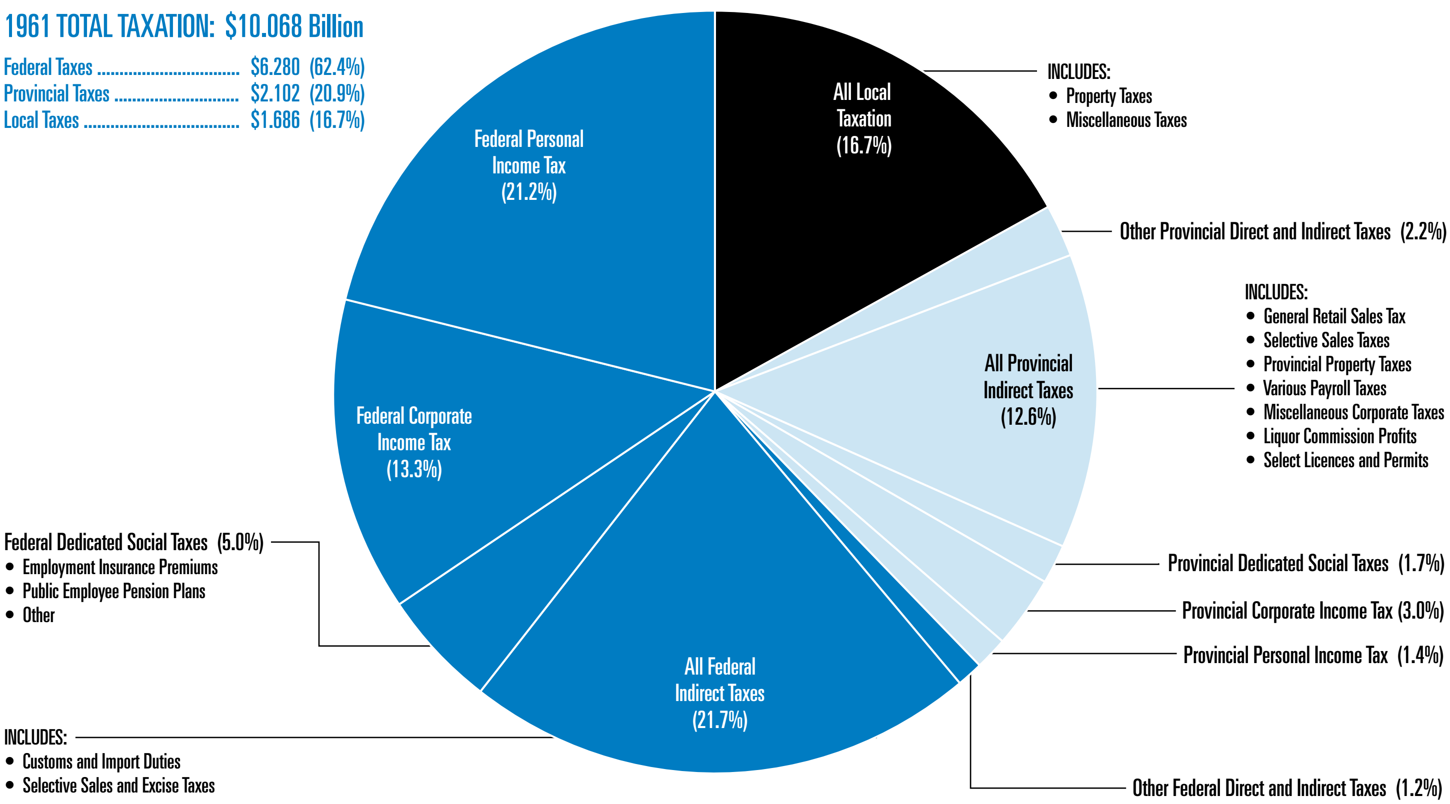
Federal Taxes	$262.937	(50.5%)
Provincial Taxes	$211.115	(40.6%)
Local Taxes	$46.251	(8.9%)

SOURCE: Derived by Canada West Foundation from the National Income and Expenditure Accounts of Statistics Canada (Cat. No. 13-21-3S, Historical Issue and 13-001-X, First Quarter 2008).



1961 TOTAL TAXATION: $10.068 Billion

Federal Taxes	$6.280	(62.4%)
Provincial Taxes	$2.102	(20.9%)
Local Taxes	$1.686	(16.7%)



2. Tax Growth

Canada's tax profile shows that local government taxation – primarily the property tax – constitutes a relatively small share of the total tax burden. In addition, the property tax burden, relative to the burden posed by all other taxes, has diminished over time. But all of this is small comfort for taxpayers because the total tax bill has grown substantially over the years *(Figure 2, Chart 1).* Canadians paid $520.3 billion in taxes in 2007 compared to $10.1 billion in 1961.

But nominal amounts tell us very little. The population of Canada has increased from 18.3 million in 1961 to 33.0 million in 2007 and prices have increased almost seven-fold *(Figure 2, Chart 2).* A better measure of tax growth factors in both population increases and price escalation due to inflation. This *inflation-adjusted* or *real per capita* tax measure puts the tax bill in perspective. The $520.3 billion tax bill in 2007 amounts to just under $15,800 for each and every Canadian in real per capita dollars. In 1961, the $10.1 billion paid equated to just over $3,900. Thus, it is fair to say that the total tax burden has increased by a factor of four over the past 45 years *(Figure 2, Chart 3).*

There are a number of reasons for this growth. First, Canadians are wealthier today than 45 years ago, so it makes sense that more taxes have been paid as wealth has increased. Second, Canada's social safety net was only in its infancy in the early 1960s. Since then, new social programs have been introduced and existing programs were expanded and enriched. To cover the cost, taxes rose. Third, the 1990s saw governments increase taxes and introduce new ones to eliminate a sizeable public sector deficit. Some of these new taxes have since been eliminated, but others are still in play as governments continue to pay down public debt and restore funding to programs that were scaled back to address the fiscal imbalance.

Understanding the four-fold increase in taxation is helpful, but it hardly completes the picture. A proper assessment of growth proceeds down three tracks: 1) real per capita growth rates of each tax under consideration; 2) the contribution of each tax to the total real per capita increase in taxation; and 3) growth of various taxes relative to an independent control variable such as the size of the economy – gross domestic product – or some measure of aggregate income out of which all taxes are paid.

FIGURE 2: Total Taxation in Canada, 1961-2007

CHART 1: Total Taxes Collected in Nominal Terms, 1961-2007

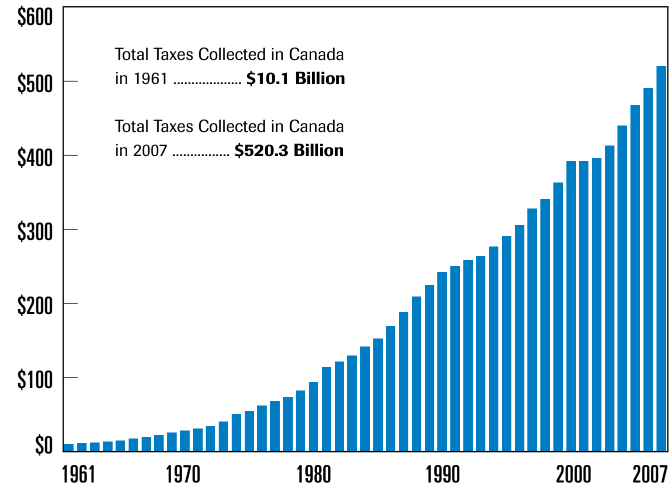


CHART 2: Consumer Price Index Trendline and Population Counts, 1961-2007

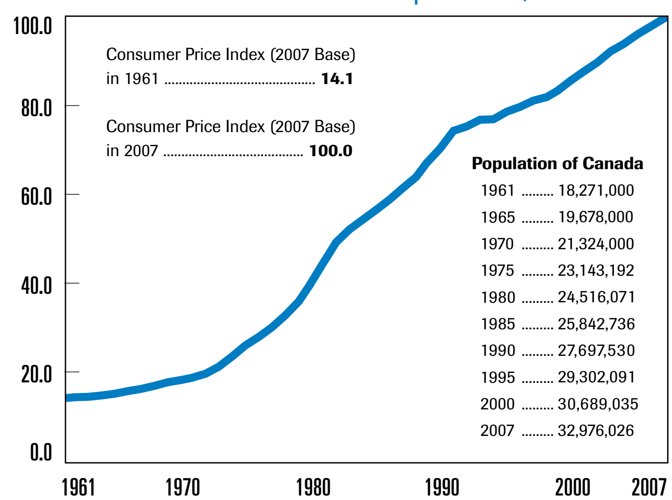
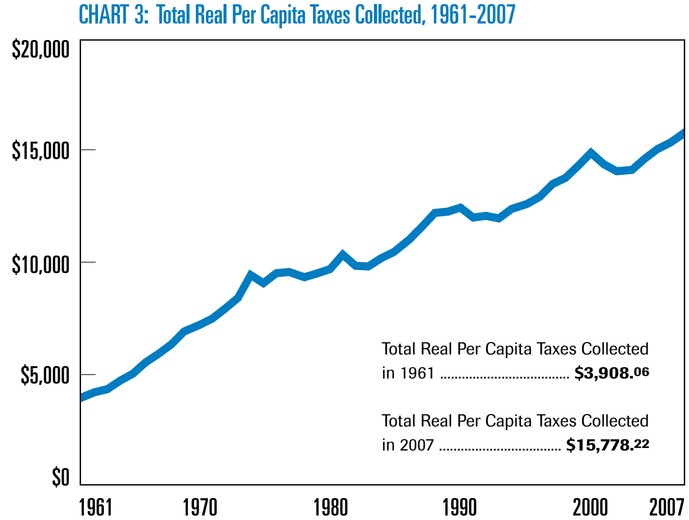


CHART 3: Total Real Per Capita Taxes Collected, 1961-2007



SOURCE: Derived by Canada West Foundation from the National Income and Expenditure Accounts of Statistics Canada (Cat. No. 13-21-3S, Historical Issue and 13-001-X, First Quarter 2008).

Figure 3 presents growth rates of the various taxes collected by federal, provincial, and local governments. The figure shows the nominal tax amounts collected by governments in 1961 and 2007 and the inflation-adjusted or real per capita amounts. The last column in the chart shows the average annual growth rate of the real per capita tax amounts between 1961 and 2007. A number of findings emerge.

- *First, local government tax collections have one of the lowest average annual growth rates:* Real per capita taxes collected by local governments — mostly property taxes — have grown on average by only 1.7% annually. The only tax source with a lower average annual rate of growth is federal indirect taxation at 1.6%. The low growth rate of federal indirect taxation is primarily due to recent cuts in the GST from 7% to 5%. If these rate cuts had not occurred, local government taxes would certainly be the slowest growing form of taxation over the past 45 years.

- *Second, federal and provincial direct taxation, particularly personal income taxes and dedicated social taxes, have the highest average annual growth rates:* Real per capita provincial personal income tax has grown on average by 10.2% annually while federal personal income tax has grown by 3.5% annually.

The higher growth rate of provincial personal income tax revenue is somewhat deceptive. This provincial tax source experienced a massive spike in the early 1960s as tax points were transferred to the provinces. This tax shift ripples through the last 45 years by dramatically increasing the average annual growth rate. Since 1961, real per capita taxes paid to the federal government for various social expenditures have averaged 5.2% growth per year while provincial exactions have averaged 5.4%. All of this comes as no surprise given the introduction of new income support programs and the taxes required to pay for a bevy of federal and provincial social programs inaugurated in the 1960s.

- *Third, federal and provincial corporate income taxes, indirect taxes, and other taxes show less robust growth than direct taxation, but have clearly outpaced local government taxation:* Real per capita amounts collected through federal corporate income taxes have averaged 2.4% annual growth over the last 45 years while provincial corporate income taxes have averaged 4.6% growth. Provincial indirect tax revenue has averaged 3.9% growth and other provincial taxes 3.7%. Federal indirect tax revenue has grown little due to recent tax cuts, but growth in other taxes has been relatively robust averaging 4.5% annually.

FIGURE 3: Average Annual Growth Rates of Real Per Capita Taxes, 1961 and 2007
(All Federal, Provincial, and Local Taxes in Nominal $ Billions and Real 2007 Per Capita Dollars)

		1961 (Billions of Nominal $)	1961 (Real Per Capita)	2007 (Billions of Nominal $)	2007 (Real Per Capita)	Average Annual Growth (Real Per Capita, 1961-2007)
Federal Taxes:	Federal Personal Income Taxes	$ 2.130	$ 826.80	$ 118.850	$ 3,604.13	+ 3.46%
	Federal Dedicated Social Taxes	$ 0.499	$ 193.70	$ 49.577	$ 1,503.43	+ 5.18%
	Federal Corporate Income Taxes	$ 1.345	$ 522.08	$ 38.758	$ 1,175.34	+ 2.42%
	Federal Indirect Taxes	$ 2.188	$ 849.31	$ 48.818	$ 1,480.41	+ 1.59%
	Federal Other Taxes	$ 0.118	$ 45.80	$ 6.934	$ 210.27	+ 4.47%
	TOTAL FEDERAL TAXES	**$ 6.280**	**$ 2,437.69**	**$ 262.937**	**$ 7,973.58**	**+ 2.73%**
Provincial Taxes:	Provincial Personal Income Taxes	$ 0.141	$ 54.73	$ 73.572	$ 2,231.08	+ 10.20%
	Provincial Dedicated Social Taxes	$ 0.174	$ 67.54	$ 19.293	$ 585.06	+ 5.44%
	Provincial Corporate Income Taxes	$ 0.304	$ 118.00	$ 18.663	$ 565.96	+ 4.58%
	Provincial Indirect Taxes	$ 1.270	$ 492.97	$ 88.644	$ 2,688.13	+ 3.87%
	Provincial Other Taxes	$ 0.213	$ 82.68	$ 10.943	$ 331.85	+ 3.66%
	TOTAL PROVINCIAL TAXES	**$ 2.102**	**$ 815.92**	**$ 211.115**	**$ 6,402.08**	**+ 4.74%**
Local Taxes:	Local Indirect Taxes	$ 1.686	$ 654.45	$ 46.251	$ 1,402.56	+ 1.71%
	TOTAL LOCAL TAXES	**$ 1.686**	**$ 654.45**	**$ 46.251**	**$ 1,402.56**	**+ 1.71%**
	ALL GOVERNMENT TAXES	**$ 10.068**	**$ 3,908.06**	**$ 520.303**	**$ 15,778.22**	**+ 3.15%**

SOURCE: Derived by Canada West Foundation from the National Income and Expenditure Accounts of Statistics Canada (Cat. No. 13-21-3S, Historical Issue and 13-001-X, First Quarter 2008).

Focusing on growth rates helps fill in the tax picture, but it tells only half the story. A tax can record remarkable annual growth, but if it is only a small part of the total tax mix, the overall impact is marginal. *Figure 4* identifies the extent to which various taxes have contributed to the real per capita increase in taxation. In 1961, Canadians paid taxes totalling $3,900 in real per capita terms. In 2007, they paid $15,800. What taxes and what governments contributed the most to the increase?

- *Direct federal and provincial taxes on personal income have had the largest impact:* Federal and provincial personal income tax and dedicated social taxes have been responsible for 57.1% of the four-fold increase in taxation since 1961. Growth in federal personal income tax contributed 23.4% of the increase, followed by provincial personal income tax at 18.3%. Dedicated federal social taxes have contributed 11.0% while similar direct provincial taxes have contributed 4.4%.

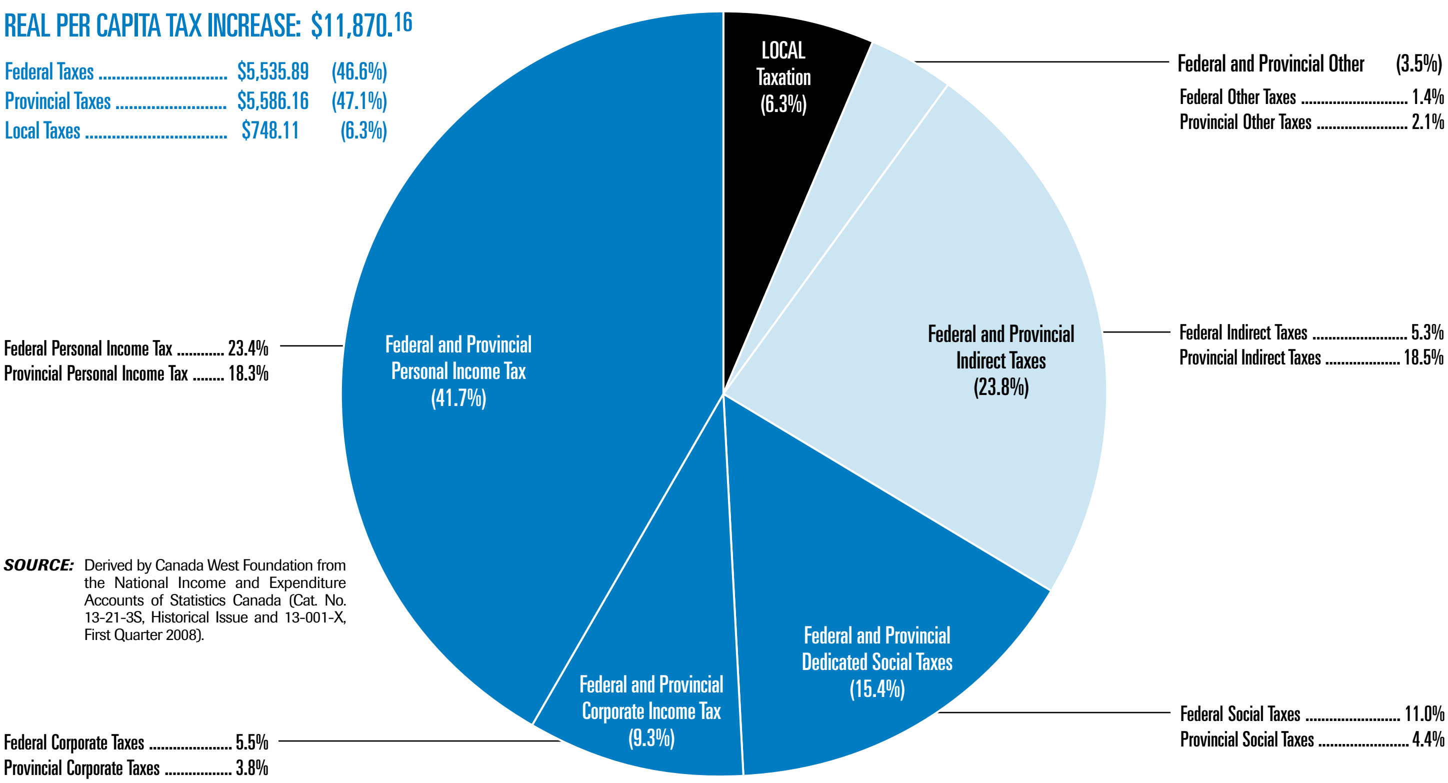
- *Federal and provincial indirect taxes run a distant second:* All forms of federal and provincial indirect taxation were responsible for 23.8% of the total increase. Provincial indirect taxation did, however, contribute more. Indirect taxes at the provincial level contributed 18.5% compared to 5.3% federally.

- *Federal and provincial corporate income taxes are in third place:* Federal and provincial corporate income tax contributed 9.3% to the total increase in taxation. Other federal and provincial taxes – a mix of both direct and indirect – have contributed very little at only 3.5%.

- *Local government taxation has contributed the least:* Local government taxes – primarily property taxes – contributed only 6.3% to the real per capita increase in taxation since 1961. For every additional dollar that Canadians have had to pay in tax over the last 45 years, a little more than one nickel had to be put on the fiscal table for all forms of local taxation, of which only a portion speaks to property taxes collected municipally.

For each additional dollar paid in tax since 1961, roughly 60¢ has come in the form of more federal and provincial personal income tax and premiums paid to federal and provincial social programs. Another 25¢ has come in the form of additional federal and provincial indirect taxation, whether that be general sales taxes or selective sales taxes. An additional 10¢ has come in the form of corporate income tax and miscellaneous federal and provincial taxes. Only about 5¢ out of every additional tax dollar paid since 1961 has come in the form of local government taxation.

FIGURE 4: Contribution of Various Taxes to the Total Real Per Capita Increase in Taxation
(1961-2007)



SOURCE: Derived by Canada West Foundation from the National Income and Expenditure Accounts of Statistics Canada (Cat. No. 13-21-3S, Historical Issue and 13-001-X, First Quarter 2008).

The tax picture is pulled into sharper focus when taxes are set against GDP or some other measure of aggregate income. This measure is critical – it relates the taxes paid to incomes earned. Conceptually, if the amount of tax is rising relative to GDP or incomes, then taxes are increasing. But if taxes are falling relative to GDP or incomes, then taxes are actually decreasing *even if the nominal amount or real per capita amount of tax has gone up.*

Figure 5 plots total taxes in Canada against GDP. As stated earlier, one of the reasons why Canadians are paying more in real per capita taxes is that they are wealthier today. In 1961, Canadian GDP stood at $41.3 billion. By 2007, GDP had risen to $1.5 trillion *(Figure 5, Chart 1).* This is the critical question – how much have taxes increased relative to the increase in GDP?

- *Total taxes as a percent of GDP:* There can be no doubt that Canadians are paying more taxes today as a proportion of the nation's wealth than in times past. *Figure 5 (Chart 2)* shows that in 1961, the total taxes paid were 24.4% of GDP. Taxes rose steadily past 30% of GDP by the mid-1970s, peaking in the late 1990s at 37% of GDP. Since 2000, however, the tax-to-GDP ratio has fallen slightly and levelled off at 34.0% of GDP.

- *Federal and provincial taxes as a percent of GDP:* All federal, provincial, and local taxes as a percent of GDP from 1961 to 2007 are plotted in *Figure 4 (Chart 3).* The general trend over the last 45 years has been rising federal and provincial taxes relative to GDP. In 1961, federal taxation was 15.2% of GDP, rising to 17.2% in 2007. Provincial taxation rose from 5.1% of GDP in 1961 to 13.8% in 2007.

- *Local taxes as a percent of GDP:* The federal and provincial taxation experience stands in stark contrast to that of local governments. Not only has local taxation been relatively constant as a proportion of GDP, it is actually *lower* as a percent of GDP today than at any time in the past 45 years *Figure 4 (Chart 3).* In 1961, local government taxes were 4.1% of GDP while in 2007 the ratio stood at 3.0%.

These data show that the blame for a rising tax bill relative to the size of the Canadian economy out of which those taxes must be paid cannot be laid at the feet of local governments. This conclusion is strengthened by the data in *Figure 6,* which focuses on local taxation as it relates to total federal and provincial taxation, federal and provincial personal income taxes, and aggregate personal disposable incomes.

FIGURE 5: Taxation and GDP, 1961-2007

CHART 1: Canadian GDP in Billions of Nominal Dollars, 1961-2007

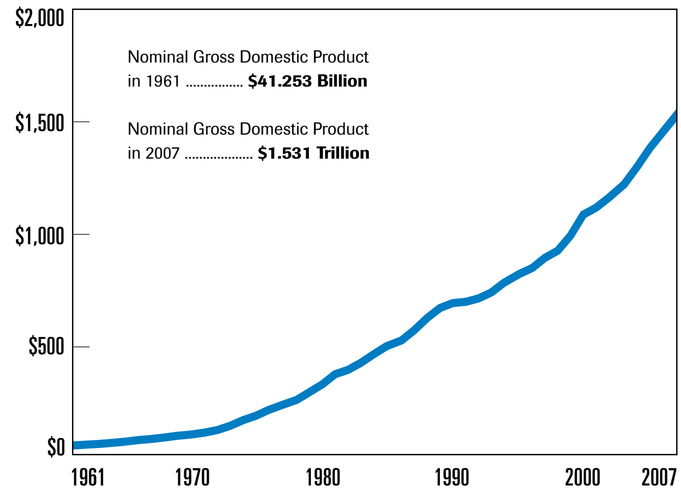


CHART 2: Total Taxes Collected as a % of GDP, 1961-2007

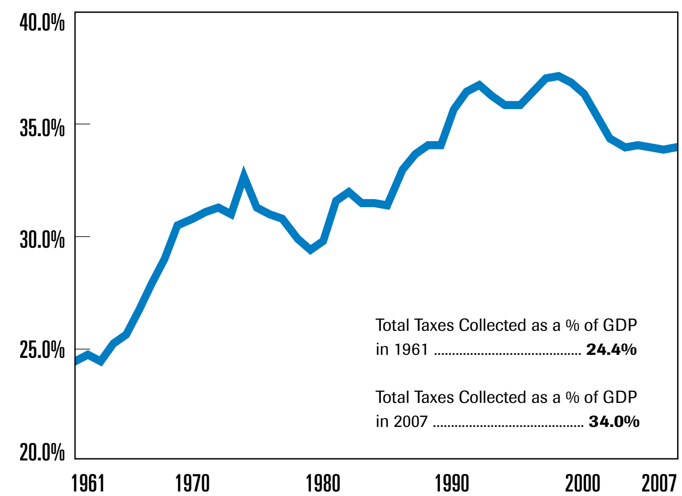
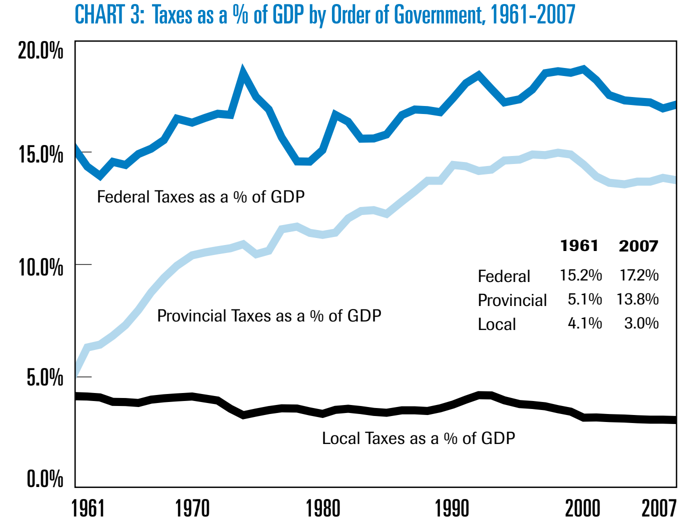


CHART 3: Taxes as a % of GDP by Order of Government, 1961-2007



SOURCE: Derived by Canada West Foundation from the National Income and Expenditure Accounts of Statistics Canada (Cat. No. 13-21-3S, Historical Issue and 13-001-X, First Quarter 2008).

FIGURE 6: Local Government Taxes, 1961-2007

CHART 1: Local Tax as a % of all Federal and Provincial Tax, 1961-2007

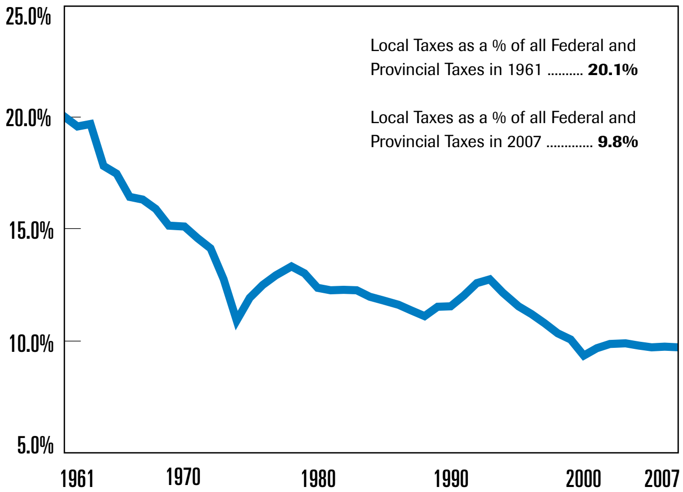


CHART 2: Local Tax as a % of Federal and Provincial Personal Income Tax, 1961-2007

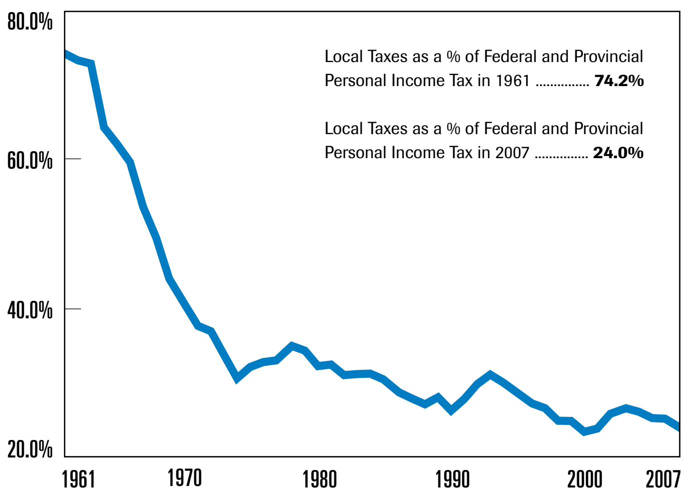
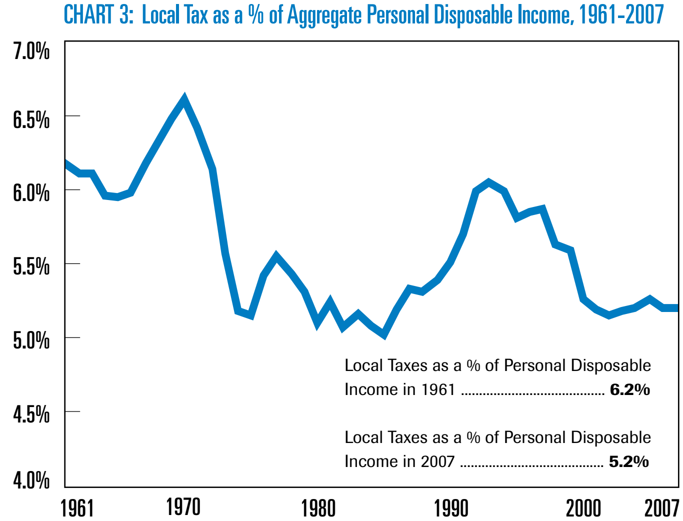


CHART 3: Local Tax as a % of Aggregate Personal Disposable Income, 1961-2007



SOURCE: Derived by Canada West Foundation from the National Income and Expenditure Accounts of Statistics Canada (Cat. No. 13-21-3S, Historical Issue and 13-001-X, First Quarter 2008).

- *Local taxes as a percent of all federal and provincial taxes:* In 1961, local government taxes were 20.1% of all federal and provincial taxes. By 2007, that ratio had slipped to 9.8%. The slide is particularly pronounced from 1960-1970, but the general trend does hold right across the entire period *(Figure 6, Chart 1).*

- *Local taxes and personal income taxes:* The broader trend above is replicated when local government taxes are expressed as a percent of federal and provincial personal income taxes *(Figure 6, Chart 2).* This is no surprise given the importance of personal income taxes to federal and provincial budgets. At the same time, it is sobering to realize that in 1961 local taxes were 74.2% of federal and provincial personal income taxes and by 2007, the ratio had slipped to 24.0%.

- *Local taxes and personal disposable income:* One of the best measures of local taxation comes when setting it against the personal disposable incomes of Canadians – the income that remains after paying direct federal and provincial taxes. Personal disposable income is the income out of which all indirect taxes – property taxes included – must be paid. Four distinct periods are seen across the data *(Figure 6, Chart 3).* The first period occurred in the 1960s, where local taxes rose relative to personal disposable income. The second period runs across the 1970s, during which local taxation fell dramatically. The third period runs across most of the 1980s, during which local taxes rose again. This result is the product of a deep recession that saw personal disposable incomes stagnate. The fourth period started in the 1990s and continues to this day. Since 1990, local taxation has continually fallen as a percentage of personal disposable income, levelling out in 2000. In 1961, local taxes were 6.2% of aggregate personal disposable incomes. The ratio bottomed out in 1985 at 5.0%. In 2007, the ratio was only marginally higher at 5.2%. In short, local taxes today are at some of the lowest levels seen over the past 45 years.

At this point, some might object to all of this because a portion of federal and provincial tax revenue eventually finds its way back to local governments in the form of intergovernmental transfers of tax revenue – operating and capital grants. It may well be that federal and provincial governments are taxing Canadians more while local governments are taxing less, but some of the increased federal and provincial tax revenue is still ending up in municipal coffers. Do not local governments have to share at least some blame for the growing tax-to-GDP ratio when local taxes and transfers are considered together? Absolutely not.

FIGURE 7: Transfers to Local Government, 1961-2007

CHART 1: Real Per Capita Transfers to Local Government, 1961-2007

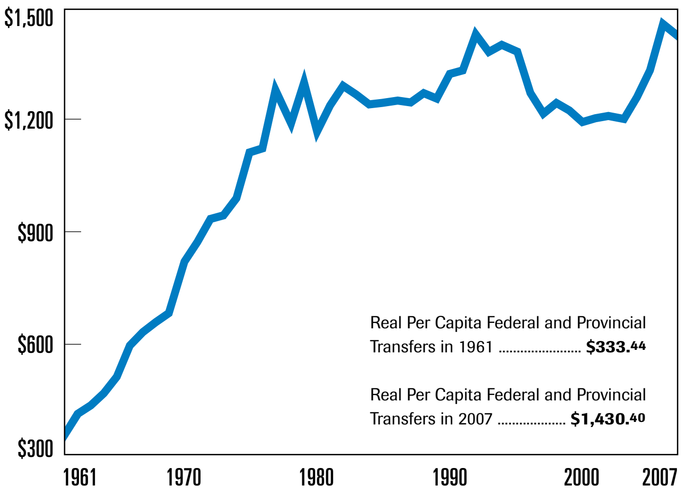


CHART 2: Transfers to Local Government as a % of GDP, 1961-2007

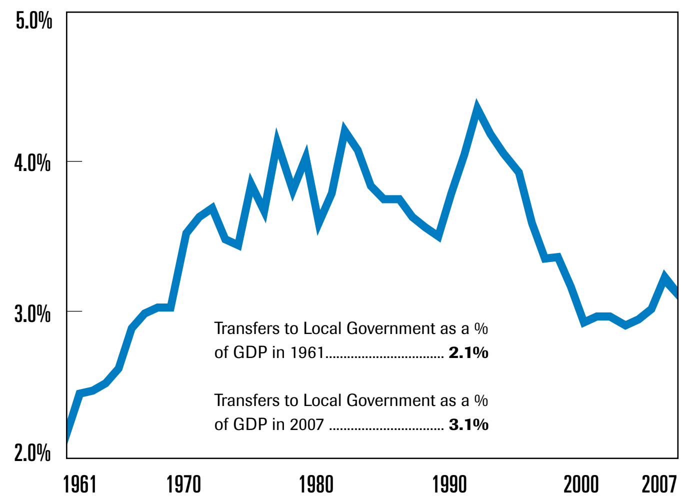
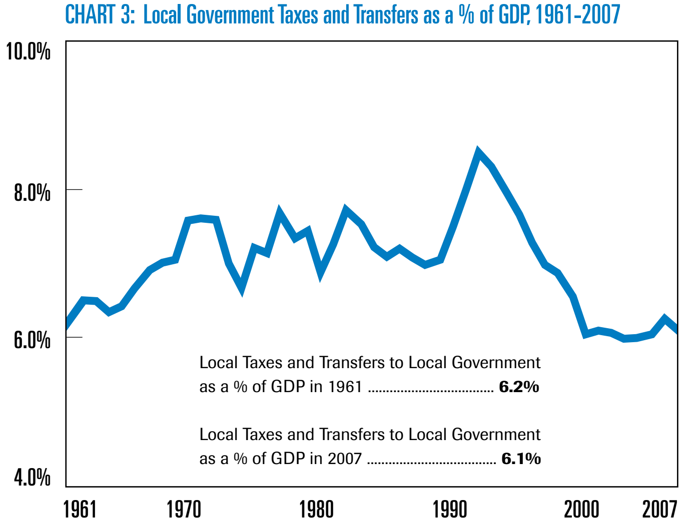


CHART 3: Local Government Taxes and Transfers as a % of GDP, 1961-2007



SOURCE: Derived by Canada West Foundation from the National Income and Expenditure Accounts of Statistics Canada (Cat. No. 13-21-3S, Historical Issue and 13-001-X, First Quarter 2008).

Figure 7 plots intergovernmental transfers received by local governments from 1961-2007. A number of important points need to be made concerning these data.

- *Real per capita transfers have not risen since 1990:* Real per capita transfers grew until 1980, after which growth stalled. A significant drop then occurred in the early 1990s as federal and provincial governments scaled back their grants. Today, real per capita transfers are at the same level as 1990 *(Figure 7, Chart 1).*

- *Transfers as a percent of GDP:* Local government transfers as a percent of GDP rose steadily until 1970, after which the ratio became quite volatile. The 1980s were a period of falling grants. A large spike in the early 1990s reflects several national infrastructure programs. Since the early 1990s, however, transfers as a percent of GDP have been in decline *(Figure 7, Chart 2).*

- *Local taxation and transfers as a percent of GDP:* The real story appears when local taxes and transfers are added, calculated as a percentage of GDP, and then tracked over the 1961-2007 period *(Figure 7, Chart 3).* First, taxes and transfers show a relatively volatile pattern. Apparently, transfers do little to smooth out local revenues when viewed against the larger economy. Second, combined local tax and transfer revenue did grow across most of the 1960s and also spiked upwards in the early 1990s. But for the most part, the trendline has been relatively flat. Third, and most important, combined local tax and transfer revenue as a percent of GDP has been falling steadily since 1990 and is now at its lowest point ever over the last 45 years.

SUMMARY: Has local government taxation – primarily driven by property taxes – increased? Not really. The amount of tax paid by Canadians to local governments, when measured against personal disposable income, is today at one of the lowest levels seen over the past 45 years. Are local government taxes out of control? Hardly. What is more, when local government taxes and transfers are combined, set against GDP, and tracked over the 1961-2007 period, it is clear that local governments are collecting much lower levels of revenue in 2007 than at any point in the past 45 years. If Canadians insist on complaining about an increasing tax burden, the focus must shift from the basket of taxes collected by local governments to the real culprit – the direct taxation of incomes that accrues entirely to the federal and provincial governments. Putting the blame on the property tax as leading to an ever increasing tax burden for the average Canadian is misplaced.

VANCOUVER

BRITISH COLUMBIA

2007 MUNICIPAL TAX REVENUE

General Property Tax	$506,037,000
Local Improvement Levies	$3,262,000
GVRD Property Taxes	$99,769,000
Other Property Taxes	$12,741,000
Total Municipal Tax	**$621,809,000**

CHART 1: Federal, Provincial, Municipal Per Capita Tax Revenue, 2007

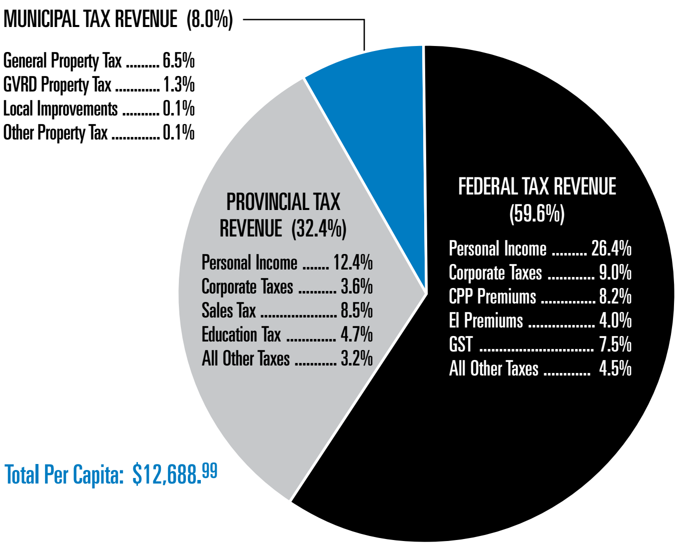
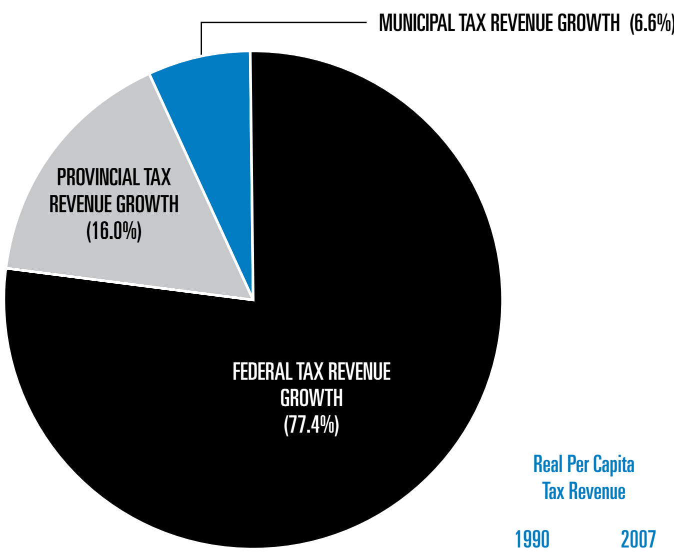


CHART 2: Contribution to Total Real Per Capita Tax Revenue Growth, 1990-2007



Real Per Capita Tax Revenue

	1990	2007
Federal	$6,012.19	$7,563.07
Provincial	$3,788.88	$4,109.67
Municipal	$883.93	$1,016.25
Total	$10,685.00	$12,688.99

SOURCE: Derived by Canada West Foundation from Vancouver's Annual Reports, federal and provincial Public Accounts and budgets, Revenue Canada's *Income Tax Statistics*, and Statistics Canada.

CHART 3: Municipal Tax Revenue Growth (Actual $ Millions, 1990-2007)

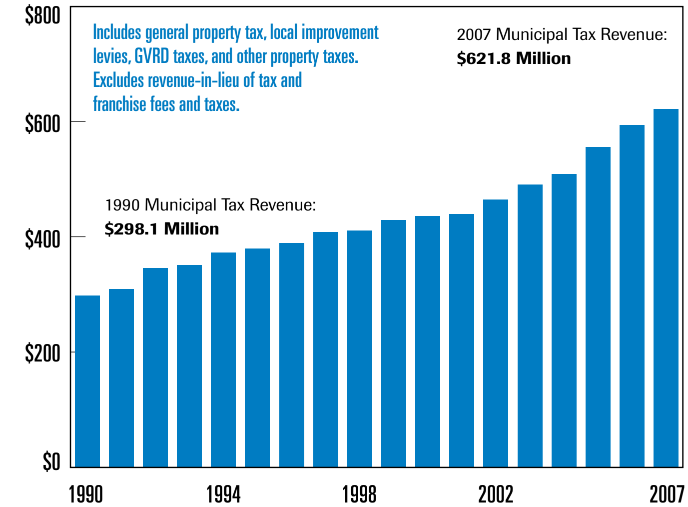


CHART 4: Real Per Capita Municipal Tax Revenue Growth (1990-2007)

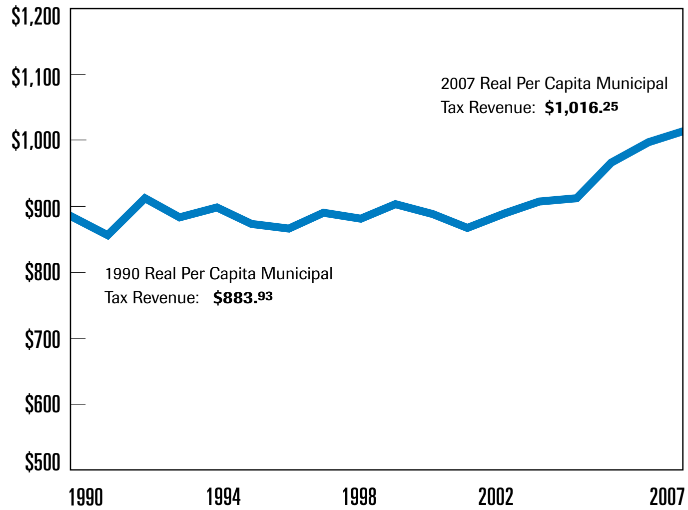
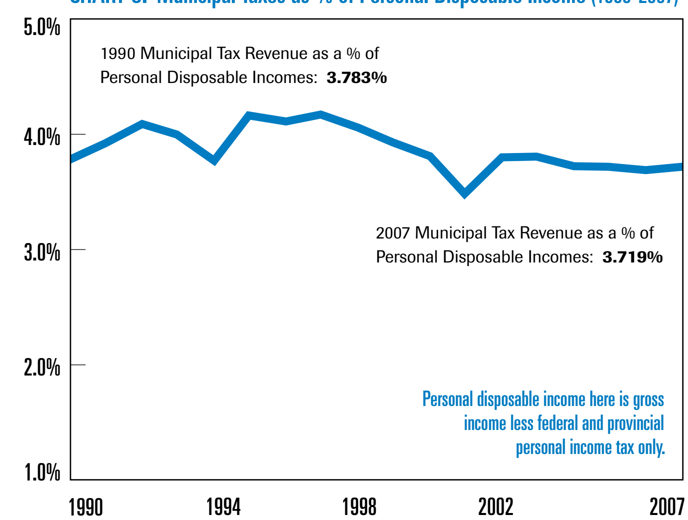


CHART 5: Municipal Taxes as % of Personal Disposable Income (1990-2007)



EDMONTON

ALBERTA

2007 MUNICIPAL TAX REVENUE

General Property Tax $530,068,000
Business Occupancy Tax $105,472,000
Local Improvement Levies $9,060,000
Other Property Taxes $5,508,000

Total Municipal Tax $650,108,000

CHART 1: Federal, Provincial, Municipal Per Capita Tax Revenue, 2007

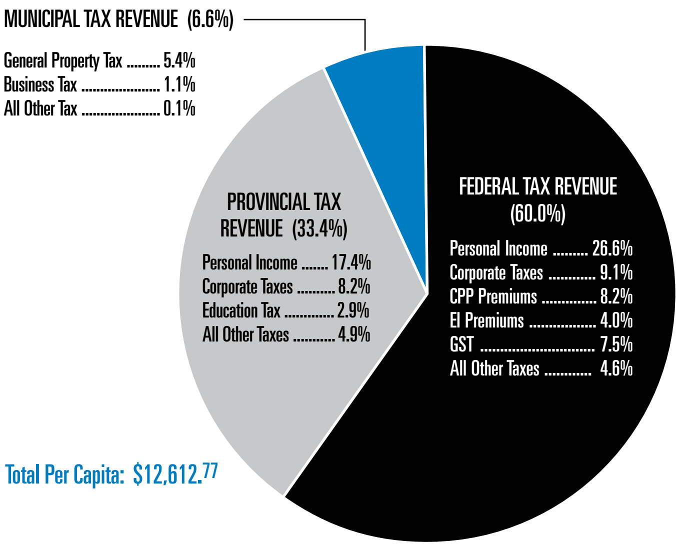
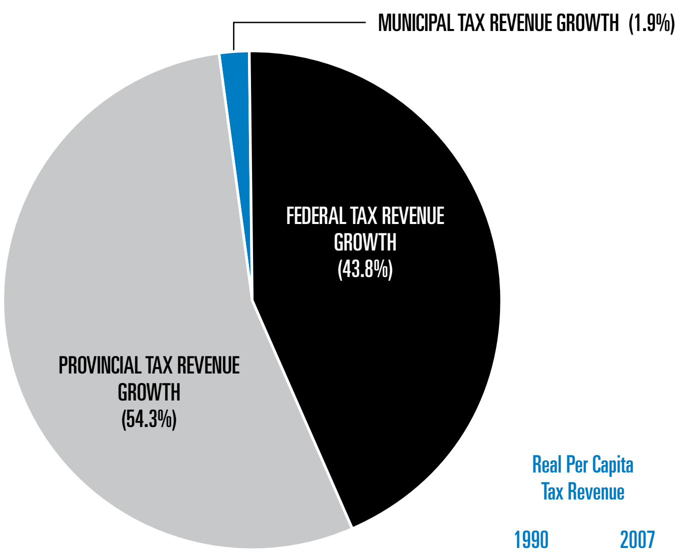


CHART 2: Contribution to Total Real Per Capita Tax Revenue Growth, 1990-2007



Real Per Capita Tax Revenue

	1990	2007
Federal	$6,530.16	$7,563.07
Provincial	$2,930.81	$4,211.90
Municipal	$792.56	$837.80
Total	$10,253.53	$12,612.77

SOURCE: Derived by Canada West Foundation from Edmonton's Annual Reports, federal and provincial Public Accounts and budgets, Revenue Canada's *Income Tax Statistics*, and Statistics Canada.

CHART 3: Municipal Tax Revenue Growth (Actual $ Millions, 1990-2007)

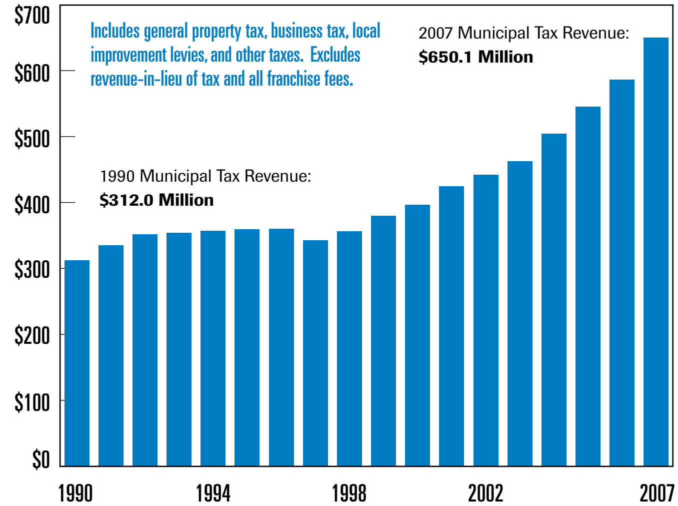


CHART 4: Real Per Capita Municipal Tax Revenue Growth (1990-2007)

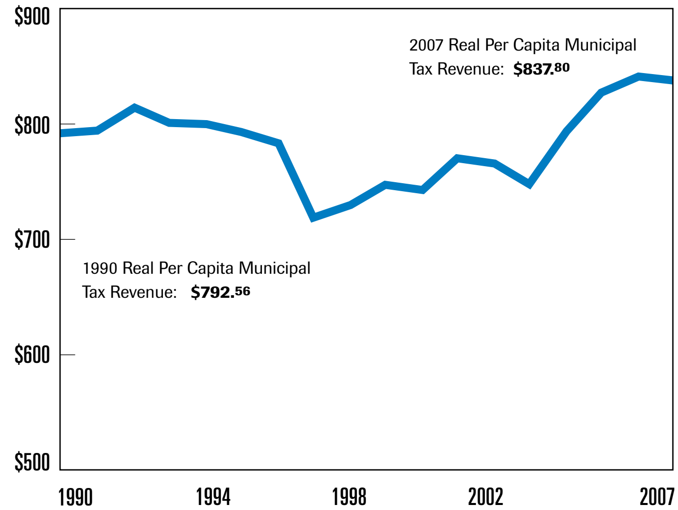
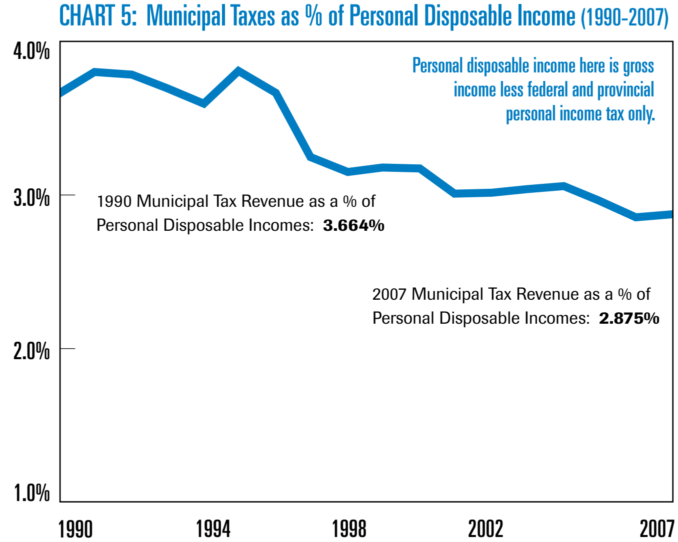


CHART 5: Municipal Taxes as % of Personal Disposable Income (1990-2007)



CALGARY

ALBERTA

2007 MUNICIPAL TAX REVENUE

General Property Tax	$800,709,000
Business Occupancy Tax	$198,195,000
Local Improvement Levies	$9,680,000
Total Municipal Tax	**$1,008,584,000**

CHART 1: Federal, Provincial, Municipal Per Capita Tax Revenue, 2007

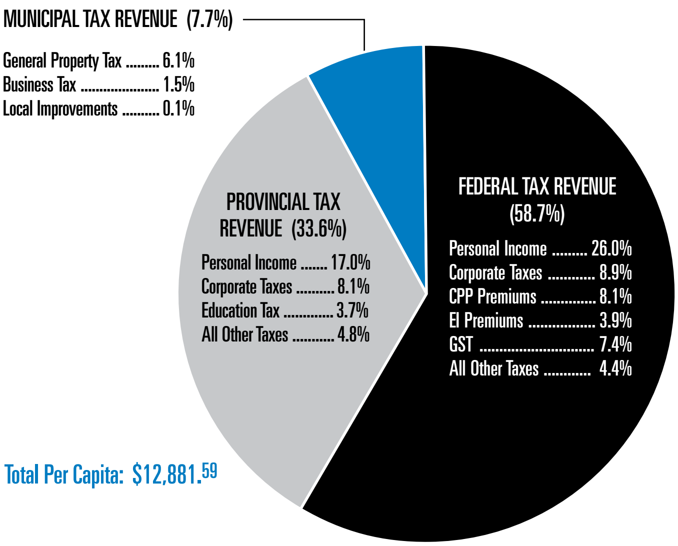
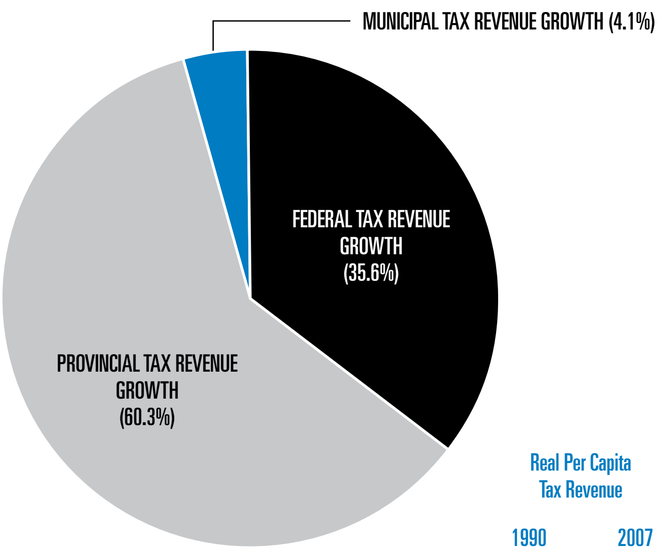


CHART 2: Contribution to Total Real Per Capita Tax Revenue Growth, 1990-2007



Real Per Capita Tax Revenue

	1990	2007
Federal	$6,769.70	$7,563.07
Provincial	$2,985.39	$4,329.66
Municipal	$898.68	$988.86
Total	$10,653.77	$12,881.59

SOURCE: Derived by Canada West Foundation from Calgary's Annual Reports, federal and provincial Public Accounts and budgets, Revenue Canada's *Income Tax Statistics*, and Statistics Canada.

CHART 3: Municipal Tax Revenue Growth (Actual $ Millions, 1990-2007)

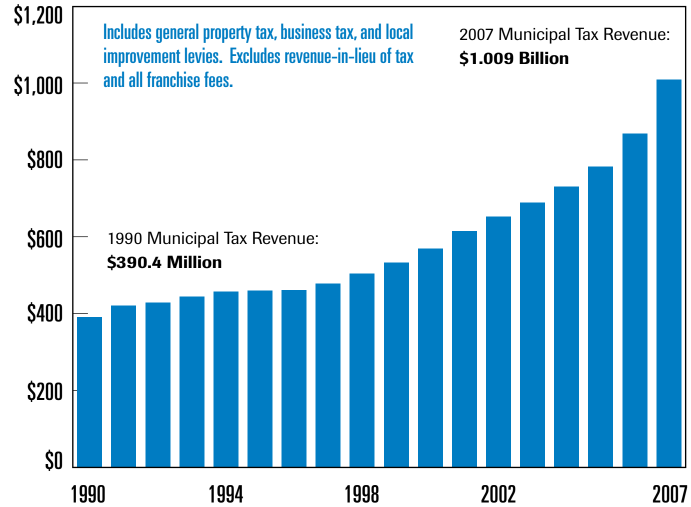


CHART 4: Real Per Capita Municipal Tax Revenue Growth (1990-2007)

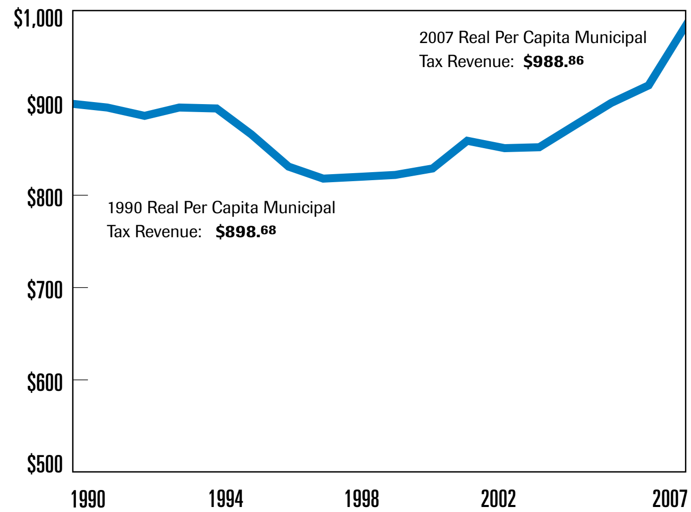
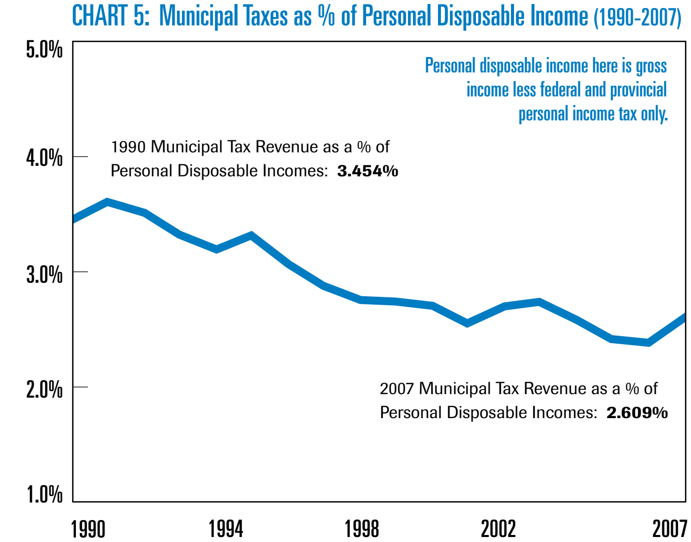


CHART 5: Municipal Taxes as % of Personal Disposable Income (1990-2007)



SASKATOON

SASKATCHEWAN

2007 MUNICIPAL TAX REVENUE

General Property Tax	$118,534,000
Local Improvement Levies	$40,000
All Other Taxes	$597,000
Total Municipal Tax	**$119,171,000**

CHART 1: Federal, Provincial, Municipal Per Capita Tax Revenue, 2007

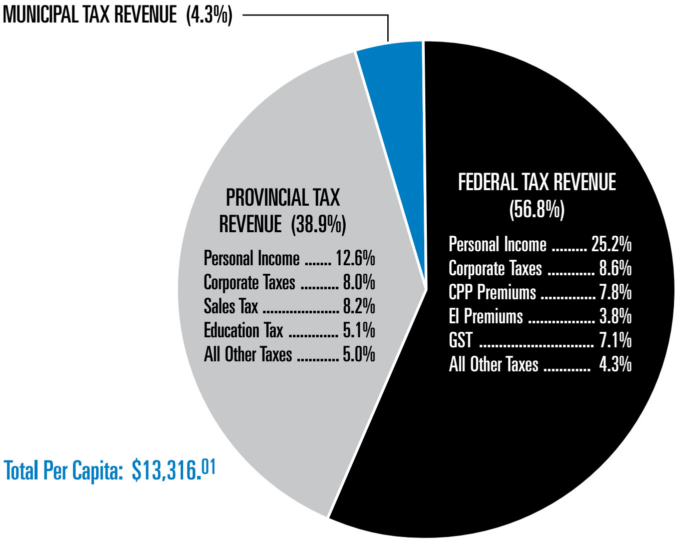
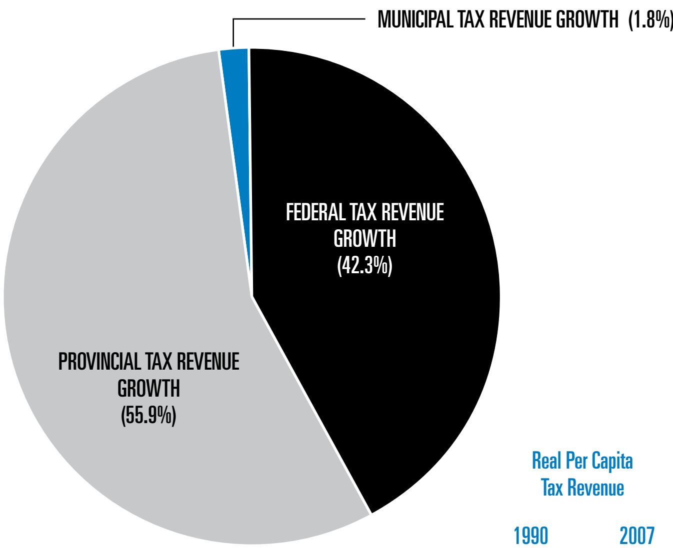


CHART 2: Contribution to Total Real Per Capita Tax Revenue Growth, 1990-2007



Real Per Capita Tax Revenue

	1990	2007
Federal	$6,242.06	$7,563.07
Provincial	$3,430.41	$5,175.39
Municipal	$522.65	$577.55
Total	$10,195.12	$13,316.01

SOURCE: Derived by Canada West Foundation from Saskatoon's Annual Reports, federal and provincial Public Accounts and budgets, Revenue Canada's *Income Tax Statistics*, and Statistics Canada.

CHART 3: Municipal Tax Revenue Growth (Actual $ Millions, 1990-2007)

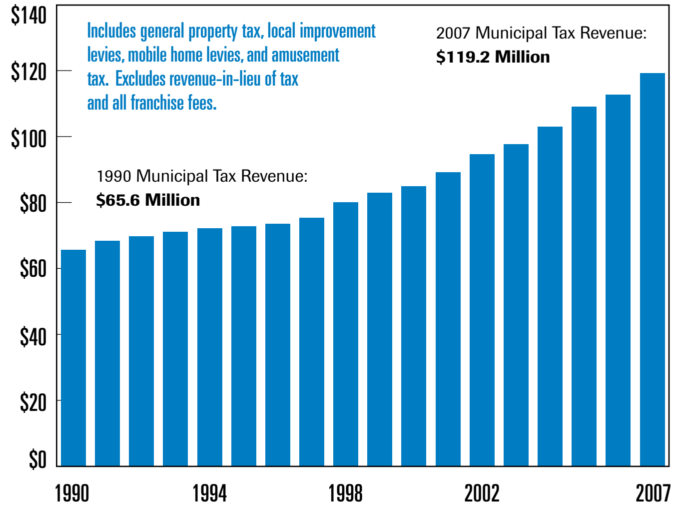


CHART 4: Real Per Capita Municipal Tax Revenue Growth (1990-2007)

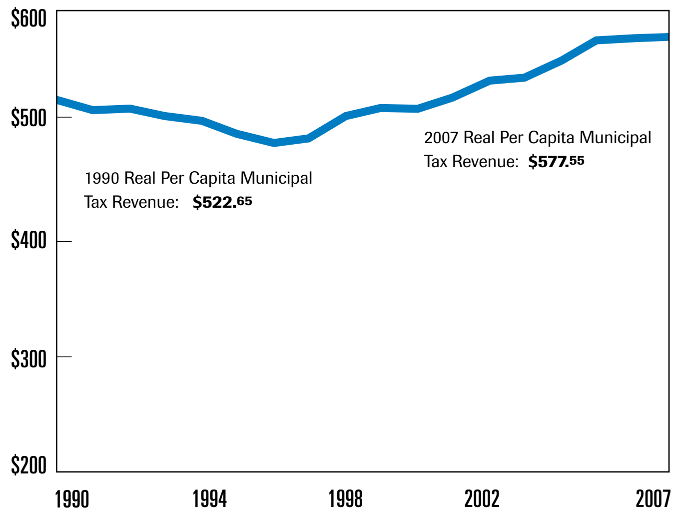
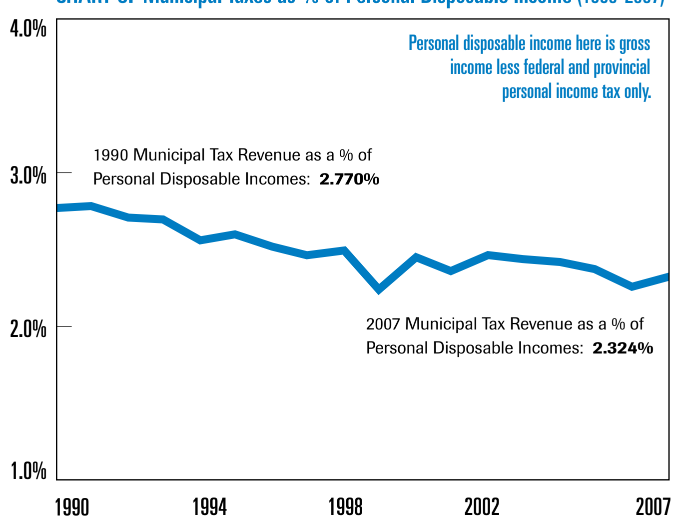


CHART 5: Municipal Taxes as % of Personal Disposable Income (1990-2007)



REGINA

SASKATCHEWAN

2007 MUNICIPAL TAX REVENUE

General Property Tax	$127,936,000
Supplemental Taxation	$881,000
All Other Taxes	$2,229,000
Total Municipal Tax	**$131,046,000**

CHART 1: Federal, Provincial, Municipal Per Capita Tax Revenue, 2007

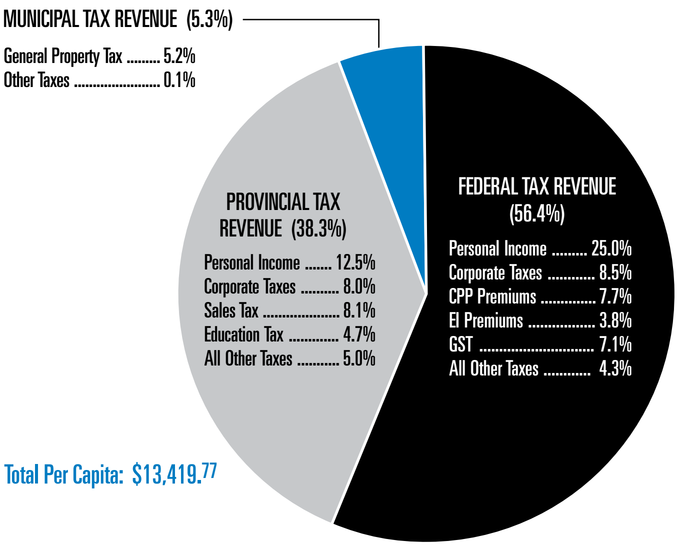
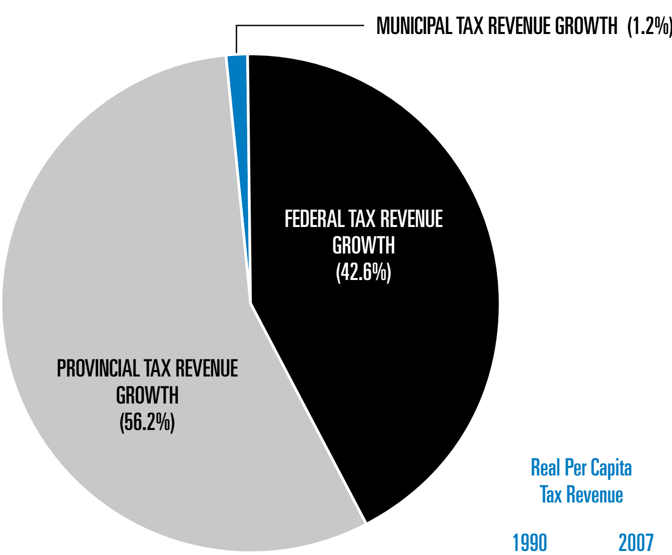


CHART 2: Contribution to Total Real Per Capita Tax Revenue Growth, 1990-2007



Real Per Capita Tax Revenue

	1990	2007
Federal	$6,306.99	$7,563.07
Provincial	$3,479.49	$5,135.52
Municipal	$686.21	$721.18
Total	$10,472.69	$13,419.77

SOURCE: Derived by Canada West Foundation from Regina's Annual Reports, federal and provincial Public Accounts and budgets, Revenue Canada's *Income Tax Statistics*, and Statistics Canada.

CHART 3: Municipal Tax Revenue Growth (Actual $ Millions, 1990-2007)

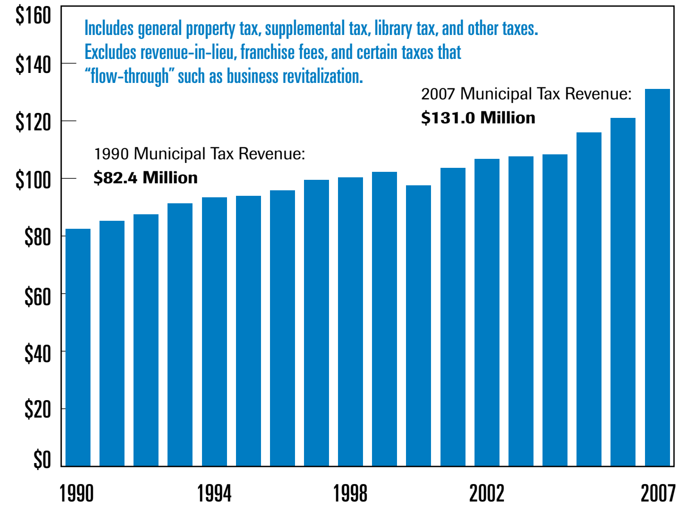


CHART 4: Real Per Capita Municipal Tax Revenue Growth (1990-2007)

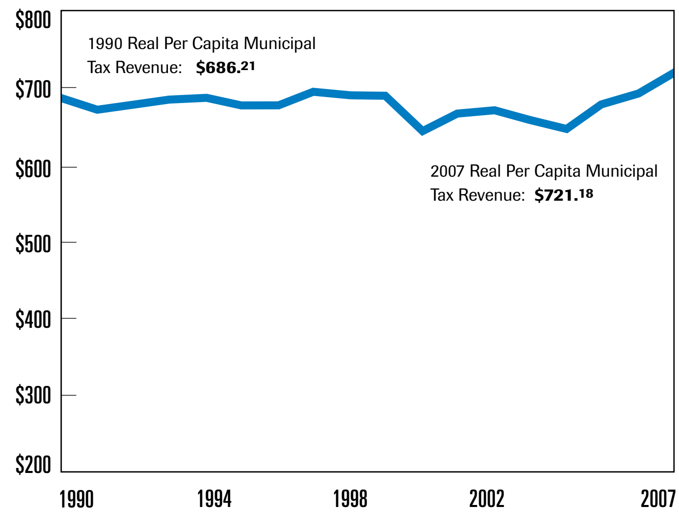
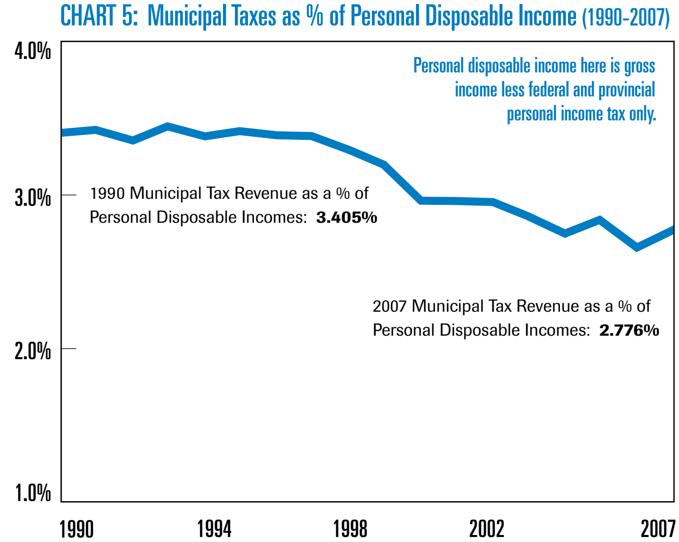


CHART 5: Municipal Taxes as % of Personal Disposable Income (1990-2007)



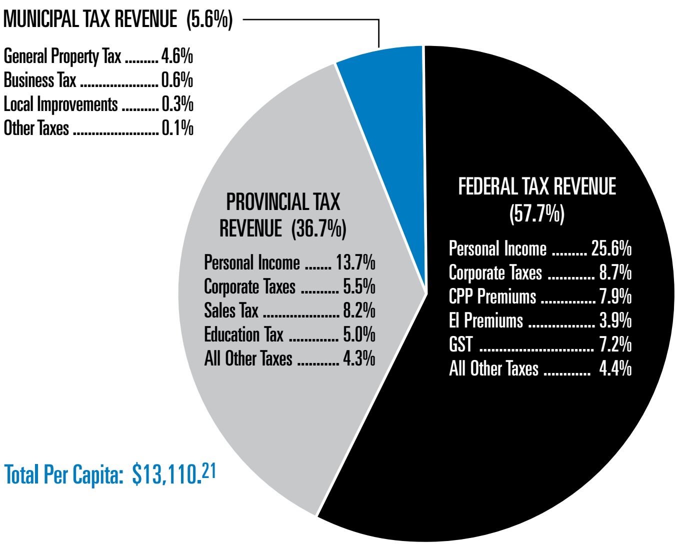
WINNIPEG

MANITOBA

2007 MUNICIPAL TAX REVENUE

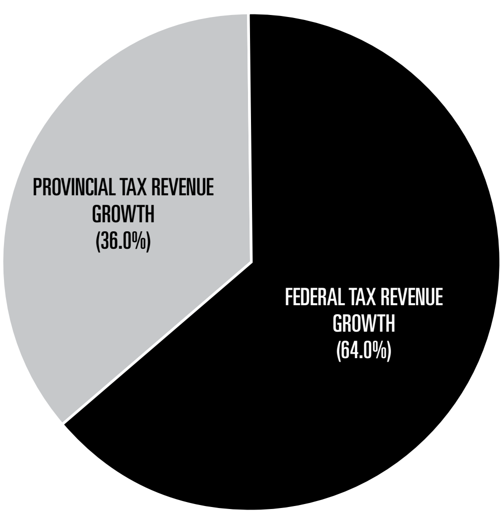
General Property Tax	$390,489,000
Business Occupancy Tax	$56,057,000
Local Improvement Levies	$28,695,000
Other Taxes	$6,246,000
Total Municipal Tax	**$481,487,000**

CHART 1: Federal, Provincial, Municipal Per Capita Tax Revenue, 2007



Total Per Capita: $13,110.21

CHART 2: Contribution to Total Real Per Capita Tax Revenue Growth, 1990-2007



Real Per Capita Tax Revenue

	1990	2007
Federal	$6,187.47	$7,563.07
Provincial	$4,035.81	$4,810.24
Municipal	$841.35	$736.90
Total	$11,064.63	$13,110.21

SOURCE: Derived by Canada West Foundation from Winnipeg's Annual Reports, federal and provincial Public Accounts and budgets, Revenue Canada's *Income Tax Statistics*, and Statistics Canada.

CHART 3: Municipal Tax Revenue Growth (Actual $ Millions, 1990-2007)

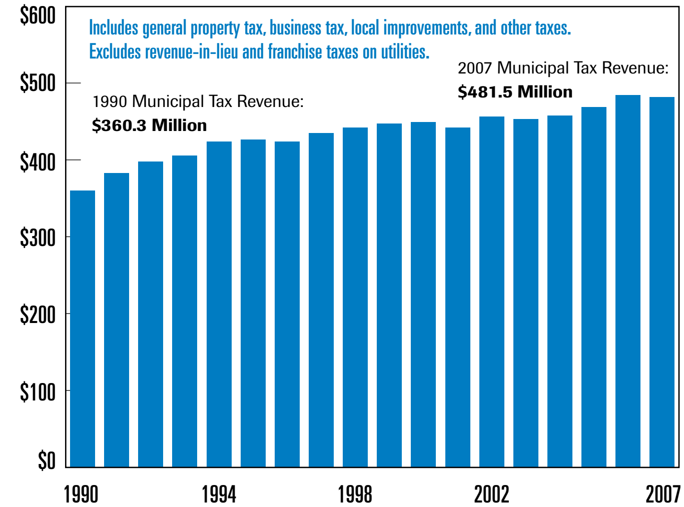


CHART 4: Real Per Capita Municipal Tax Revenue Growth (1990-2007)

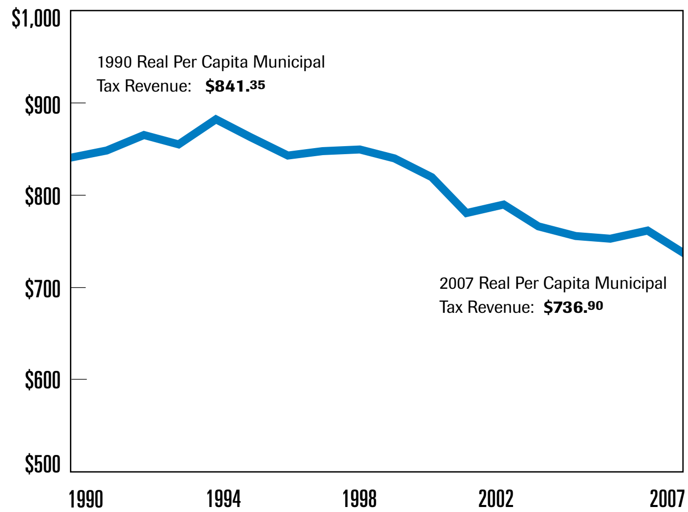
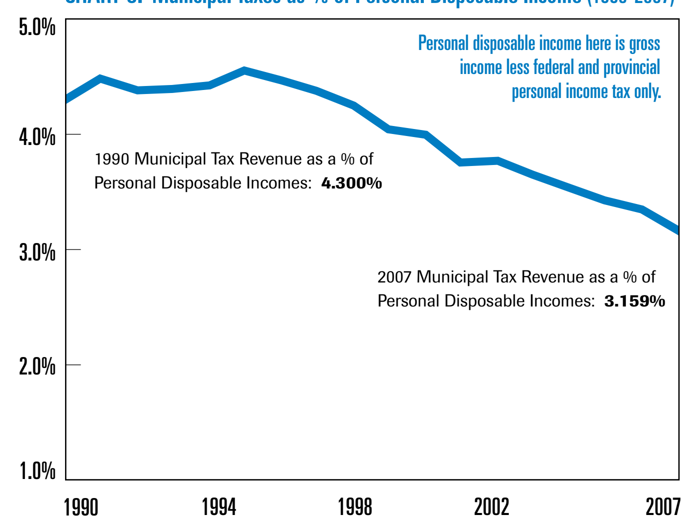


CHART 5: Municipal Taxes as % of Personal Disposable Income (1990-2007)



PROPERTY TAX BURDEN: City-Specific Data

National taxation trends raise an interesting question. How well do six of the West's largest cities – Vancouver, Edmonton, Calgary, Saskatoon, Regina, and Winnipeg – reflect the larger national pattern? For an answer, we need to move beyond the *National Accounts* and turn to the individual *Public Accounts* produced by the federal government, the provinces, and individual cities. The various charts in the city-specific dataset on pages 16 to 21 are based on the *Public Accounts* and provide valuable information to help answer the question. Unlike the *National Accounts,* these data run across a shorter time period (1990-2007) but they also focus more properly onto the municipal portion of the property tax as opposed to all taxes collected across the whole local government sector.

1. Tax Profile

The city-specific dataset provides a detailed tax profile for each of the six cities *(Charts 1-5).* Generally speaking, these individual tax profiles reflect the broader national trends outlined above with only minor differences.

- *On average, municipal taxes in the six cities comprise only 6.2% of all taxes collected:* This amount includes all forms of property tax and a very small portion of non-property based tax, but excludes all revenue-in-lieu. The municipal tax burden was the lowest in Saskatoon at 4.3% of total taxes levied and the highest was in Vancouver at 8.0%. Most other cities were very close to the average of 6.3%. These results are lower than the national data, which includes other local government actors and other local taxes in addition to municipal property tax.

- *Federal and provincial governments collect the great bulk of taxes, and personal income taxes lead the way:* In 2007, the federal government collected 58.2% of all taxes when averaged across the cities while provincial collections averaged 35.6%. Again, the single largest tax collected is federal and provincial personal income tax. Compared to the NIEA data, the federal tax take is somewhat higher and the provincial take somewhat lower. While there are a number of reasons for this, one of the most important concerns the $9 billion in Québec Pension Plan (QPP) premiums that were included in the provincial tax totals in the NIEA data but have no affect on provincial tax totals in the West.

- *Federal and provincial tax collections could be higher than the data indicate:* To estimate the tax burden, each federal and provincial tax was apportioned to the various cities based on their per capita share of these taxes. While this is a reasonable way to arrive at estimates, it does overlook the fact that most corporations are headquartered in the major cities, personal incomes are likely higher in the cities than in smaller urban and rural centres, and retail sales likely experience higher volumes in the cities. All of these have the potential to yield higher amounts of corporate and personal income tax, as well as sales tax revenue.

2. Tax Growth

- *Municipal taxes in the six western cities, measured in nominal terms, have doubled between 1990-2007:* In 1990, the six western cities collected $1.509 billion in municipal tax. In 2007, the total tax collected grew to $3.013 billion. For taxpayers, this gives the impression that municipal taxes are out of control. But this conclusion ignores the almost 700,000 more people living in the six cities in 2007 than in 1990, as well as the 50% to 60% increase in the consumer price index seen in these cities since 1990. Again, a more accurate measure looks at real per capita taxes adjusted for inflation.

- *Municipal property tax in real per capita terms has increased in the six cities but not much:* In 1990, real per capita municipal tax averaged across the six cities in 1990 were $771. This figure rose to $813 in 2007. Thus, real per capita property taxes grew by a modest 5.5% over an 18 year period or 0.3% growth annually. Over the same time period, federal tax revenues adjusted for inflation and population grew by 25.3% and the average across the four western provinces was 36.2% (Vander Ploeg 2008a). In short, federal taxes grew five times that of municipal property taxes while provincial taxes – excluding resource royalties – grew almost seven times as much.

- *Municipal property tax is responsible for little of the increase in real per capita taxes paid in the six cities since 1990:* When averaged across the six cities, municipal taxes were responsible for only 2.6% of the real per capita increase in total taxes paid since 1990. Municipal taxes in Winnipeg contributed nothing since its real per capita municipal property tax take actually fell 12.5% between 1990-2007. Municipal tax in Regina contributed 1.2% to the real per capita increase, followed by Saskatoon at 1.8% and Edmonton at 1.9%. Municipal taxes in Calgary and Vancouver contributed sightly more at 4.1% and 6.6% respectively.

■ *Municipal property tax, as a percent of personal disposable incomes in the cities, is lower in 2007 than in 1990.* Again, the most important measure of property tax is to relate the amount of tax to aggregate personal disposable incomes. If this ratio is rising, then taxes are being effectively increased. If the ratio is falling, then taxes are being decreased. In 1990, the amount of municipal tax as a percent of local personal disposable income averaged 3.6% across the six cities. By 2007, the average ratio had fallen to 2.9%. The largest drop occurred in Winnipeg, where municipal property tax went from 4.3% of personal disposable income to 3.2%. This is followed by Calgary (from 3.5% to 2.6%), Edmonton (3.7% to 2.9%), Regina (3.4% to 2.8%), Saskatoon (2.8% to 2.3%), and Vancouver (3.8% to 3.7%).

SUMMARY: The ongoing debate over property taxes really speaks to only a small portion of the total tax bill facing the average Canadian. Further, the burden posed by the property tax, when compared to the sum total of all other taxes, has generally fallen across the local government sector over the last 45 years. It has also fallen in each large western city over the past 18 years. To be sure, the burden posed by the property tax can radically differ between individual Canadians. Those who have retired from the workforce, those on fixed incomes, and those with moderate or low income may pay very little personal income tax. For them, the property tax can form a significant share of their total tax bill. But the essential point remains – the municipal property tax is only a small part of the total tax burden confronting the *average* Canadian.

Of all the ways to look at growth in municipal property taxes, the most significant is to set the revenue collected against the personal disposable incomes being earned in the city. This measure is critical for two reasons. First, all taxes – whether direct or indirect – must be paid out of incomes earned regardless of whether the actual tax base is income itself or the value of one's property. This leads to the second point. In order for any actual increase in taxation to be effected, the increase needs to result in a higher percentage of one's income being taken following the increase than was being taken prior to the increase. If this condition is not fulfilled, then any so-called "increase" in taxation is quite debatable – it has not necessarily resulted in a greater portion of one's income going to pay the tax. Ultimately, it remains fact that the property tax has come to consume less of personal disposable income today than in times past.

PERFORMANCE CRITERIA

With a basic tax picture in hand, we can proceed with reviewing the property tax and its role in financing western Canada's rapidly growing and modern urban centres. It is important to underscore once again that the property tax is a relatively small portion of the total tax load in Canada. Its share of the tax load has also fallen relative to other taxes and relative to the personal disposable incomes out of which property taxes must be paid. With this contextual caveat in mind, the following list represents a set of criteria against which any tax can be assessed and subsequently judged. The individual criteria form a long list, but they can be loosely organized around a set of broader themes that makes the list more manageable.

1) Local Considerations:
- Fit with Local Purpose
- Dedicated Local Tax
- Local Control

2) Tax Base:
- Identification
- Valuation
- Size of the Tax Base
- Stability of the Tax Base
- Mobility of the Tax Base

3) Revenue Effect:
- Revenue Adequacy
- Revenue Reliability and Flexibility
- Elasticity

4) Economic Effects:
- Equity
- Allocative Efficiency
- Neutrality and Distortions

5) Administration:
- General Administration
- Revenue Collection
- Compliance
- Enforcement

6) Taxpayer Criteria:
- Simplicity
- Visibility
- Transparency
- Accountability
- Legitimacy

Before evaluating the property tax against these criteria, a number of important points should be kept in mind.

- *Some of the criteria are closely related:* High or low scores on one criteria can result in high or low scores on other criteria. Some of the criteria also pull in opposite directions – a high score on one necessitates a low score on another. In other words, the criteria are not always neutral. An advantage in one area can produce a disadvantage in another area.

- *Assessment must focus on the inherent features of the tax and how it actually works on the ground:* Any tax can receive a high theoretical score based on its inherent features, but the reality may be different because of how the tax is employed. Both must be considered. Sometimes a lack of research or thoughtful consideration results in a reality that is far from clear. Here, we are left with posing questions to stimulate debate.

- *Some criteria are more important than others:* It is difficult to objectively determine how this affects the overall performance of the property tax. For example, are taxpayer concerns less important than economic considerations? If so, to what extent should this impact our overall view of the tax? While no evaluation can ignore this consideration, weighing the criteria and striving for strict empirical measurements is outside the purposes of this paper.

- *Judgements of performance cannot always be objective:* This type of exercise involves a strong subjective element. To help keep the evaluation from veering into the ditch on either the left or right side of the road, the performance of the property tax must sometimes be assessed relative to how other taxes perform.

SUMMARY: Criteria upon which to evaluate the property tax can be grouped around a number of themes including local autonomy and fit with the purposes of local government, the tax base, the revenue effect, economic considerations, administration, and taxpayer concerns. While similar commentary can be found in numerous other reports, studies and articles, this paper endeavours to hit the highlights and bring all the advantages and disadvantages of the property tax under one roof. Conventional wisdom has often assumed a number of things about the property tax that are incorrect or just incomplete. Indeed, the property tax at first glance appears to perform well on a number of important fronts. But given the heavy and singular reliance of our cities on this one tax source, it certainly deserves more than just a passing glance.

LOCAL CONSIDERATIONS

> *"The property tax has endured because it is conceptually attractive. As opposed to state sales and income taxes, property tax revenue is raised locally to support local public services. Thus, the connection between the source of the revenue, the property, and the services being provided is strong."* – David Brunori (Brunori 2004)

> *"Elected leaders are running up against what budget makers have known for years – as unpopular as the property tax may be, it is one of the most viable ways to fund local government."* – John Fritze (Fritze 2008)

> *"The property tax is a good tax for local governments."*
> – Enid Slack (Slack 2007)

> *"The property tax is inherently flawed as a source of funding for cities' growing needs."*
> – Derek Burleton (Burleton 2002)

> *"A truly local tax is one in which the local government determines the tax base, sets the tax rates, collects the tax, and keeps the revenues."*
> – Enid Slack (Slack 2005)

1. Fit With Local Purpose

- *Criteria:* It is generally conceded that the property tax is a good fit for local governments. But how well does the property tax fit with the purposes behind local government today? Are there obvious links between the tax and its appropriateness in the local context? What is the historical and international experience with the property tax? Does the property tax intuitively make sense?

- *Performance:* The property tax has a long history in financing local government and traditionally there has been good if not strong historical support and appreciation for the purposes behind the tax. This is certainly the case in Canada, and in many other countries as well. With few exceptions, local governments in most countries collect at least some amount of property tax. There are numerous reasons why the property tax endures as a local tax source. One of the most important is simply the purpose behind local government and the nature of its responsibilities. Many municipal services funded by the tax are directed towards property. These services provide a benefit that is then *capitalized* into property values – the services increase the value of property. The property tax makes good sense if only because it requires property owners to pay for the very services that increase the value of their property holdings.

The property tax has long been defended based on this and other logical ties. But there are a number of wrinkles in the argument. First, not everyone who pays property tax actually owns property. Those who rent accommodations or lease a business location can and often do pay property tax indirectly through their rental payments. But renters cannot, by definition, benefit from any subsequent increase in property value. In fact, the benefits here may only serve to result in higher rental payments or lease costs. To be sure, this may make sense because renters do enjoy the benefits of municipal services. But in the end, only the owners of property really benefit from any increase in asset value.

Second, not all municipal services have a strong and direct link to property. The degree to which traditional municipal services directly benefit properties is not uniform. There is a big difference between a paved street, a concrete sidewalk, and a park right across the road and the civic museum, art gallery or affordable housing unit located 10 kilometres away in the downtown core. Thus, the logical ties here can be strong or weak depending on the nature of the service or infrastructure in view. Certainly it cannot be said to hold right across the board.

Third, municipal service responsibilities are changing and expanding. This is particularly the case for Canada's larger cities. In the past, municipal responsibilities were generally limited to such things as maintaining local roadways, streets, and sidewalks, curbing public drunkenness and profanity, and even controlling the running of cattle and wild animals, itinerant salesmen, and things like general noise and nuisances. But since the first provincial-municipal relationships were constructed in the mid-1800s, municipal responsibilities have expanded dramatically.

Today's cities are involved in telecommunications systems, fibre-optic networks, and electrical transmission utilities. They operate community welfare systems, public housing facilities, hospices, hostels, homeless shelters, and help run hot lunch and after school care programs. Many cities also engage in the treatment of drug addiction and other medical and mental illnesses, as well as economic development, hazardous waste remediation, environmental cleanups, and search and rescue. Big cities are also working on alternative fuel and energy technology as well as advanced transit systems, and are competing on the world stage to host the Olympics, the Pan-American Games, the Commonwealth Games and World Expositions. The list goes on. The duties and responsibilities of our big cities have clearly evolved in a direction that weakens the historical appeal of the property tax.

Further, many of these new responsibilities are directed toward "people" services as opposed to "property" services. The responsibility of local government used to go to the property line only – they did streets, sidewalks, lighting, water, sewer, and waste. Traditionally, municipal government existed in order to facilitate local decision-making, provide services to property, and address local needs (UBCM 2001). In many ways, this is simply no longer the case.

Finally, while the property tax appears to be a good fit conceptually, the practical reality is that many countries have decided the opposite. In fact, only three of the more than two dozen OECD nations see fit to collect more local property taxes than Canada *(Discussion Box 1)*. International experience shows that local governments in the great majority of OECD countries collect the great bulk of their local tax revenue from other tax sources, including personal and corporate income tax, general sales taxes, selective sales taxes, and other taxes. Do these countries know something we Canadians do not? Or, does the property tax simply have such a strong hold over the status quo that we are unable or unwilling to look at other options? In the end, the property tax may very well provide a decent fit for traditional local purposes. But the activity of many local governments today is not restricted to these traditional purposes. International experience shows that the property tax is not the only tax that can be made to work for local governments.

2. Dedicated Local Tax

■ *Criteria:* The property tax has traditionally been understood as the reserve of local governments and subsequently defended as an important tool for promoting local autonomy, decentralized decision-making, and community-based solutions. Local autonomy cannot exist aside from the power to tax — without an adequate revenue source that it can control, local governments will simply serve as an administrative extension or agent of larger and more powerful governments. The property tax has often been defended as a unique and dedicated local tax that has allowed cities to establish at least a modicum of autonomy from other governments. Cities, by capitalizing upon and maintaining this distinct fiscal jurisdiction, have established themselves as a key component within the larger political decision-making process and this carries significant benefits for local citizens. But how well does the property tax fulfill this role as a dedicated local tax?

DISCUSSION BOX 1:
Local Property Tax in Various Members of the OECD

As shown in the chart below, most local governments in countries around the world collect at least some of their total tax revenue from the property tax. However, the extent by which the property tax contributes to local tax revenue varies widely. Local governments in countries that have strong historical ties to Great Britain or served as former British colonies (usually members of the Commonwealth of Nations) depend much more heavily on property taxation than do most other countries. Local governments in countries such as Australia and Ireland, for example, are completely dependent on property taxation and local governments in Canada, New Zealand, the US, and the UK are also highly dependent on property taxation.

This stands in sharp contrast to the experience of local governments in other European countries and those of southeast Asia. While local governments in some of these OECD countries collect about half of their total tax revenue from property taxes (e.g., Netherlands, Korea, France), the great majority actually collect very little revenue from this tax source (e.g., Austria, Norway, Denmark). Local governments in Belgium and Sweden are unique — they collect no property tax at all.

Local governments in countries that collect very little property tax are much more likely to collect their tax revenue from income taxes — both personal income tax and corporate income tax. For example, local governments in Norway, Denmark, Luxembourg, Finland, and Sweden collect over 90% of their local tax revenue from income taxes. The usage of local sales taxation tends to be more sporadic.

The international diversity in local government tax sources does not appear to be strongly correlated to federal status. Local governments in federal states can depend heavily on property taxes (e.g., Canada and the US) or lightly (e.g., Germany, Austria, Belgium). The same applies in unitary states. Local governments in some unitary states are heavily dependent on property taxation (e.g., New Zealand, Ireland) while local governments in other unitary states have low dependence (e.g., Norway, Italy, Denmark).

Percentage of Total Local Tax Revenue From Various Tax Sources, 1998

Members of the OECD and Commonwealth of Nations

	Property Tax	Income Tax	General Sales Tax	Selective Sales Tax	All Other Taxes
Australia	100.0%	0.0%	0.0%	0.0%	0.0%
Ireland	100.0%	0.0%	0.0%	0.0%	0.0%
UK	99.5%	0.0%	0.0%	0.0%	0.5%
Canada	92.7%	0.0%	0.1%	1.4%	5.7%
New Zealand	90.8%	0.0%	0.0%	9.1%	0.0%

Members of the OECD Only

	Property Tax	Income Tax	General Sales Tax	Selective Sales Tax	All Other Taxes
United States	72.8%	6.3%	11.1%	9.8%	0.0%
Netherlands	62.8%	0.0%	0.0%	37.1%	0.0%
Korea	51.4%	15.3%	0.0%	29.9%	3.4%
France	50.6%	0.0%	0.0%	10.2%	39.1%
Portugal	43.2%	21.6%	18.4%	16.4%	0.4%
Spain	34.6%	26.4%	11.6%	23.8%	3.5%
Poland	33.6%	63.0%	0.0%	3.3%	0.1%
Japan	31.1%	47.2%	7.1%	13.7%	1.0%
Hungary	22.6%	0.1%	70.2%	6.3%	0.7%
Italy	17.3%	12.9%	0.0%	14.9%	54.9%
Switzerland	15.4%	84.3%	0.0%	0.3%	0.0%
Germany	15.0%	79.1%	4.8%	0.9%	0.2%
Iceland	13.2%	80.2%	6.5%	0.0%	0.0%
Austria	9.6%	56.0%	19.6%	10.7%	4.1%
Norway	7.8%	90.2%	0.0%	2.0%	0.0%
Denmark	6.3%	93.6%	0.0%	0.1%	0.0%
Luxembourg	6.0%	92.6%	0.0%	1.2%	0.3%
Czech Republic	4.9%	89.8%	0.0%	5.2%	0.1%
Finland	3.9%	95.8%	0.0%	0.0%	0.2%
Turkey	2.3%	27.7%	25.3%	4.8%	39.9%
Belgium	0.0%	84.2%	1.7%	12.5%	1.6%
Sweden	0.0%	100.0%	0.0%	0.0%	0.0%

SOURCE: Derived by Canada West Foundation from data presented in Kitchen and Slack (2003). Original data comes from the OECD's *Revenue Statistics 1965-1999.* (Note: Numbers may not total 100.0% due to rounding.)

- *Performance:* This defense of the property tax makes good sense, and there is nothing inherent in the tax that would seem to work against it. In fact, many public policy commentators are quite prepared to offer a strong apologetical defense of the property tax in so far as it is restricted and used for local purposes. The reasoning here is quite simple and is based upon the inherent ability of the property tax to establish and maintain a strong connection between the source of the tax revenue – *local property* – and the services funded by that tax revenue – *local services and infrastructure.*

However, this traditional defense of the property tax has been seriously compromised given recent developments and its current administration. Historically, the property tax was indeed the sole reserve of local governments, employed for local civic services provided by city hall, local education services provided by locally elected school boards, and maintenance of local hospitals provided by locally elected health boards. This traditional view of the property tax harkens to a world that no longer exists.

In most Canadian provinces, the local school board and the local health authority have gone the way of the dinosaur, replaced by regional school boards and regional health authorities. In the province of Alberta, the new Alberta Health Services Board will collapse the regional health authorities into one "superboard." Along with these changes, many provinces have centralized the education portion of the property tax, which has served to weaken the local nature of the tax. Unfortunately, many taxpayers do not distinguish between the local municipal property tax levy and the provincial education levy, and this gives the impression that the costs of the local services they receive are simply too high.

The localized nature of the property tax does differ between provinces. Even among the four western provinces, wide variations exist. In British Columbia, for example, the cities of Vancouver and Victoria must share property tax room with the province for education, the regional governing bodies of the Greater Vancouver Regional District (GVRD) and the Capital Regional District (CRD), as well as several independent provincial agencies such as the BC Finance Authority and BC Assessment. This differs from the state of the property tax room in Alberta, Saskatchewan, and Manitoba, which appears to be more narrowly shared.

In short, the historical appeal of the property tax as a locally dedicated tax has weakened, and this hits directly on one of the most important reasons for using the property tax. In some ways, the current situation is highly ironic. Over the last decade, it seems as if a new paradigm is emerging with respect to local government autonomy and accountability. This new paradigm can be seen in the many recent changes to provincial legislation governing municipal affairs. In Canada, such changes have come in the form of natural person powers being granted to municipalities, more freedom of action within broadly defined policy spheres, and even new charter legislation granting distinct status to larger cities in several Canadian provinces. At the same time, the one unique fiscal tool traditionally dedicated to facilitating local decisions has been slipping away.

3. Local Control

- *Criteria:* The ability of the property tax to facilitate local autonomy and decision-making depends on the degree of local control that can be exercised over the tax. How well can the property tax perform on this criteria? What degree of control is actually exercised?

- *Performance:* There is no dispute that the unique features of the property tax allow for a high degree of local control over virtually all aspects of the tax. In large part, this is due to the relative immobility of the tax base. Unlike income and sales taxes, there is nothing inherent within the property tax that prevents local governments from exercising significant administrative decision-making with respect to the tax, whether that be the tax base, assessment practices and procedures, the tax rate, or the usage of the tax revenue. In theory, this potential for a high degree of localized control makes the property tax attractive as a funding mechanism. However, the reality here is much different. Cities are just not as free with the property tax as most would like to believe, and this lack of freedom hits on most aspects of the tax.

First, local governments do not have unfettered control over the local tax base, which is often defined and identified by provincial legislation. For example, most provinces stipulate a set of properties that are to be exempt from property tax. Any disputes that arise over these exemptions have to be negotiated with provincial municipal officials. Further, cities do not have the power to tax provincial and federal government properties.

Rather, these governments provide a grant in the form of *revenue-in-lieu of tax.* These amounts can be quite significant – running into the millions of dollars – and are particularly important for cities that serve as the provincial capital. Yet, cities have little to no control over these amounts, which are often decided unilaterally at the discretion of federal and provincial governments. If a dispute does arise over *revenue-in-lieu,* the amount in dispute may be withheld until the issue is settled. This contrasts with disputes over property taxes that are dependent on the mill rate. These usually have to be paid upfront whether an appeal is ongoing or not. If an appeal succeeds, an amount is typically refunded (Kitchen and Slack 2003).

Various aspects of assessment are also controlled by provincial legislation. For example, most provinces mandate the type of valuation to be used for assessment and what percentage of assessed value will be used for tax purposes. Provinces can also define the various classes and categories of properties, how value will be defined for these properties, and the maximum differential rates of effective taxation that can apply between these properties. In some provinces, the process of assessment itself is not always locally conducted either, and provinces can also be heavily involved in various aspects of the property tax appeal process.

When it comes to establishing the rate of tax, cities generally enjoy much more freedom. By controlling the mill rate, local governments also control how much property tax revenue is raised. At the same time, the rate of tax does not operate independently from assessment. It is the combination of the two that determines how the total amount of tax revenue is to be distributed among various property owners.

Technically, cities are also free with respect to the usage of the property tax revenue they collect. But it is important to remember that local government operates as a creature of the province, which frequently requires cities to use locally generated property tax revenue to meet provincially mandated expenditure responsibilities, standards, and policy goals. In the absence of any other significant tax source, cities are often forced to use property tax revenue for purposes that are not always appropriate. For example, it is generally agreed that the property tax is ill-suited for government expenditures that have a strong income redistributive component to them, such as community and social services or the provision of affordable housing. Cities do not always have much say over such matters.

To be sure, there may be very good reasons for provincial involvement in the administration of the property tax. For example, provincial direction works to ensure uniformity in assessment and the maintenance of a relatively uniform property tax system across the provincial jurisdiction. This is often needed to ensure operation of a reasonable granting process. Not all grants are provided on per capita considerations – some are given based on variations in the value of the local tax base. A certain measure of uniformity is required if such grants are to be properly employed.

The dispute here is not whether a certain measure of provincial control is desirable. That is neither here nor there. What is in dispute is the degree of local control currently exercised over the property tax. A truly local property tax is one where local government determines the tax base, decides on assessment, sets the tax rate, collects the tax, keeps the revenue, and is free to expense that revenue. If none of these are decided locally, then the revenue in view here is not a local tax strictly speaking. Rather, the revenue amounts to a grant or a system of tax revenue sharing. At a minimum, control over the tax rate is required for any revenue to be considered a local tax. Seen from this vantage point, the property tax does operate as a local tax, but perhaps only marginally so. In the end, local control is not all it either could or even should be.

SUMMARY: Defenders of the property tax are right in their assertion that it provides a good fit with the traditional purposes behind local government. They are also correct in pointing out that historically, the property tax has been the sole reserve of local governments and this has enabled them to carve out a modest yet important niche within the governing process. In addition, there is nothing inherent within the property tax that prevents local governments from exercising a high degree of control, thereby enhancing local autonomy, decision-making, and governmental accountability. The problem is that all of this speaks to a time and place that has since come and gone. Local government has expanded well beyond its traditional role, a significant portion of the property tax has been centralized within the provincial decision-making process, and local governments simply do not exercise as much control over the property tax as some would have us think. Is the property tax the only tax that can be made to work for local government today? Is the property tax even the best tax to fund local government today? Perhaps not – at least according to the larger international experience.

THE TAX BASE

"Valuation is an art, not a pure science."
– *Michael E. Bell (Bell 1999)*

"The method of assessing property tax in Saskatchewan is widely held to be complex, cumbersome, and excessive when compared to other jurisdictions."
– *Saskatchewan Chamber of Commerce (2008)*

"It is a broad tax. Property tax reaches all sectors of the economy – residential, agricultural, forestry, commercial, industrial, and utility. This also adds to the stability of the tax."
– *New York State Office of Real Property Services (2008)*

"Because the tax is a realty tax, the base is more or less fixed and the tax relatively certain."
– *Douglas J. McCready (McCready 1984)*

"Property cannot run away and hide from tax collectors."
– *Enid Slack (Slack 2007)*

1. Identification

■ *Criteria:* A key consideration behind any tax concerns the nature of the tax base. While there is much to consider, a logical starting point simply concerns the ease with which the tax base can be identified and whether taxpayers themselves can see and understand what is being taxed. How does the property tax come out based on this criteria?

■ *Performance:* The property tax base is the assessed value of land and improvements within the boundaries of a distinct local government. As long as those local boundaries are established and not in dispute, identification of the tax base is relatively straightforward. The tax base also rests upon a highly tangible item. As such, the tax base is relatively clear to taxpayers. Easy identification of the tax base is a unique strength of the property tax. For the most part, conventional thinking on the matter typically ends here. But it is worth drilling down a little further.

The inherent assumption behind the property tax is that property value is a fair measure – or proxy – of individual wealth. While there is certainly truth here, the value of property is not the sole measure of wealth, and neither may it be the best measure. Wealth is a function of a number of things – current income earned, past income earned and saved, and the value of various assets purchased and owned. We must at least admit from the outset that the value of real property is only one measure of wealth.

A second and more important concern emerges when one thinks carefully about the description of the property tax base, which is often expressed as the value of real property owned. It is the last word in this description – *owned* – that should cause eyebrows to lift. The fact is, much of the property subjected to property tax is not owned. An individual or business may indeed hold title to a property, but title and ownership are two entirely different matters. A good part of the property tax base is not owned but is mortgaged. For many, the property they "own" is comprised of an equity component and a debt component. Assessed value does not distinguish between the two. As such, the tax actually targets at least some of the value in property that has been borrowed. Why not tax that outstanding student loan as well? What about the balance on that credit card?

One should not overplay this hand. Yet, it raises an interesting question. Can taxing amounts that have been borrowed serve as a proxy for wealth? It certainly sounds crazy. But if banks and mortgage companies borrow only to those who demonstrate an ability to repay, the property tax may loosely reflect some type of ability-to-pay consideration. Then again, it may do so only if eyes are turned away from the US "mortgage melt-down."

These thoughts are not well established in the property tax literature, but that has not stopped some from boldly equating the property tax to the almost universally despised corporate capital tax. Capital taxes target both shareholder equity and the debt of large corporations. Indeed, some business groups in Canada have accused the property tax on this very point. The argument has been made that property taxes amount to nothing more than a milder form of capital tax.

2. Valuation

■ *Criteria:* Before any tax can function, there must be some way to effectively measure the value of the tax base, and to do so with fairness, ease, and at relatively low cost. How does the property tax function under this criteria?

■ *Performance:* Unlike most other taxes, there is no completely objective measure of the property tax base. Contrasting the property tax with income and sales taxes brings the difficulty into view. Once the income for tax purposes has been defined, that income can be objectively measured in the form of actual dollars earned. With a sales tax, the tax base always carries an objective value in the form of the price paid for a good or service. But the value of property can only be arrived at through assessment – a process of estimation that carries a certain amount of subjective risk. When it comes to the property tax, no issue is more important and oftentimes more hotly debated and contested than the assessment process used to value property.

This lack of objectivity in the tax base brings its own set of challenges. Assessment requires the establishment and maintenance of an administrative bureaucracy of trained professionals, and the process itself can be labour intensive, expensive, and open to dispute. Assessment is as much art as it is science, and even experienced and accredited appraisers can disagree on the value of the same property. Much depends on a regular flow of reliable data and information that can feed into the assessment process. Unintentional errors and oversights can occur when there are delays in the flow of information, when the sale of certain properties are infrequent, and when improvements are undertaken without permits. Some have concluded that non-intentional assessment errors have occurred along a number of different lines. For example, older residential properties tend to be under-assessed relative to new dwellings (Kitchen 2000).

None of this is benign. Under-assessment and under-taxation is an ongoing risk that carries implications for the equitable distribution of the property tax burden, not to mention exposing local governments to continual appeals. A high number of appeals can affect revenue stability from year to year, undercutting an often cited advantage of the property tax. In some cities, it is not entirely unheard of to have 10% of the commercial assessment base under challenge.

The lack of objectivity in establishing the value of the tax base is an inherent flaw in the property tax. However, it is generally believed that assessment has improved over time, becoming more sophisticated and more fine-tuned. But the risks never completely go away. Even property tax systems based on market value with regular and frequent reassessment – perhaps the most objective process possible – contains a subjective element. In defending the property tax, no one is so brash as to suggest that mistakes in assessment have never occurred. Nor does anyone claim that mistakes will not occur in the future. The possibility for mistakes in assessment is simply taken as a given – a fact of life when living with the property tax.

3. Size of the Tax Base

- *Criteria:* A narrow tax base links to a small part of the local economy while a broad base touches on virtually everyone or everything. When it comes to local governments and their reliance on a single tax, a relatively broad tax base is desirable because it advances a number of other positive criteria. Only a broad tax base can generate sufficient revenue with relatively low rates of tax. Equity is also improved when the tax net is cast broadly and the burden of financing government is widely shared. A broad tax base shores up acceptability and legitimacy, eases administration, results in more stable revenue flows, and works against producing undesirable economic dislocations or perverse effects. On the other hand, a narrow base can generate substantial revenue only with high or even punishing rates of tax, and as the tax base narrows, equity can begin to suffer as fewer and fewer people end up paying more and more tax. This can result in taxpayers "voting with their feet" by leaving the jurisdiction. This end result is a deterioration and further narrowing of the tax base that in turn requires even higher rates of tax to provide the needed revenue. The result is a vicious circle from which escape is neither clear nor easy.

- *Performance:* The property tax is typically viewed as a broad-based tax that is quite capable of sufficiently spreading out the financial burden of local government. The property tax also has a relatively high degree of flexibility here as well, and can be structured broadly or narrowly. For example, the general residential and non-residential property tax is quite broad, the business occupancy property tax is more narrow, and special assessments are very narrow.

In some ways, the property tax is arguably not as broad as it could be simply given that several types of properties are exempted from the tax. While removing exemptions would expand the base, an even bigger concern spins around the favouring of residential properties over and above business properties – the former typically pay less property tax than the latter. However, this speaks as much to issues of equity as it does to the size of the tax base per se, and will be more fully explored in another section. Perhaps the bigger concern here relates to the broadness of the property tax base relative to other taxes. Seen from this perspective, the broadness of the property tax falters somewhat. The property tax only links to one aspect of the economy – real estate – and in that sense it is a comparatively narrow tax.

4. Stability of the Tax Base

■ *Criteria:* A key consideration in evaluating any tax is the stability of the tax base. A stable tax base is one whose value does not quickly spike up or suddenly crash in the face of unexpected economic shocks or the continual ups and downs of the larger business cycle. Stability in the tax base is a desirable quality because it produces continuous and reliable revenue streams.

■ *Performance:* As a tax base, the value of real property is quite stable and relatively insulated against happenings in the larger economy. This is particularly the case when comparing the property tax to other taxes such as income taxes and sales taxes. Real estate markets trade in assets that are valued over the long-term. The value of these assets tends to respond more slowly to short-term changes in the level of economic activity. Income taxes and sales taxes are not based on long-term assets but on the current flow of income and consumer spending. When economies boom and bust, the impact on these flows is immediate and can also be quite severe.

The stability of the property tax base is often touted as a key advantage of the tax. But this is not a hard and fast rule that applies across the board. For example, real estate values in Vancouver plunged dramatically in the 1990s on the heels of Hong Kong's repatriation to China. On the other hand, Calgary, Edmonton, and Saskatoon have all experienced "red hot" real estate markets in the last few years driving prices to unseen levels. More recent developments include a depressed real estate market in the US and threats to the Canadian economy in the wake of a global economic slowdown. Such developments do occur, and they make the job of ongoing and accurate property valuation even more difficult.

Given this, the stability of the property tax base may be somewhat of a red herring. In part, this has to do with how local governments employ the property tax. It is important to understand that the property tax is essentially a politically-driven tax as opposed to an economically-driven tax. In setting property tax rates at budget time, municipal governments first decide upon the expenditure required for the coming year. With that in hand, a decision is made on the mill rate that will produce the necessary revenue. Debate and discussion over expenditures and the required mill rate then ensue until a balanced budget is achieved.

If the value of the property tax base rises unexpectedly, the mill rate is adjusted downward to ensure that tax collections do not skyrocket past planned expenditures. If the value of the tax base suddenly slides, municipal governments adjust the mill rate upward to guarantee the needed revenue. Thus, the stability or instability of the tax base is essentially irrelevant in terms of the revenue effect, which can be manipulated by adjusting the tax rate. All of this is much different from income and sales taxes, which are more economically-driven. These taxes generally operate with a constant rate and the amount of revenue depends on the health and growth of the tax base. Rarely are income and sales tax rates adjusted. When they are changed, it is big news for taxpayers – either happy news or sad news.

Stability in the property tax is more a function of the political nature of the tax rather than the tax base itself. Certainly this argument can be made with respect to the flow of revenue. The importance of stability in the tax base may actually speak more to preserving the distribution of the tax burden across various property owners. Relative stability ensures that the tax burden does not shift around wildly in the short-term, and that is perhaps the single largest benefit of stability. But we should not be fooled into believing that the base itself produces stable revenue – this is entirely a political decision.

5. Mobility of the Tax Base

■ *Criteria:* Even the largest cities exercise authority over a relatively small geographic area. In addition, most cities are surrounded by other municipalities within close proximity. This geopolitical reality places a premium on a tax base that is relatively immobile – one that does not provide taxpayers with an easy opportunity to change their behaviour and avoid paying tax.

■ *Performance:* Perhaps the single most important advantage of the property tax is the immobility of the tax base. Land and the improvements constructed on it cannot easily get up and move out of the jurisdiction in an attempt to avoid paying tax. The property tax is much different than income taxes and sales taxes. The base of these taxes is much more mobile. In other words, people can adjust their behaviour to avoid paying tax. For example, if one municipality levies a fuel tax and another does not, consumers can avoid paying the fuel tax by buying their fuel in the municipality that does not tax fuel. Immobility of the tax base is required if the tax base is to be preserved and the tax collected.

It is difficult to argue against this unique feature of the property tax. At the same time, several qualifications are worth mentioning. It is important to recognize that real property is not perfectly immobile. While the land component of property is certainly very immobile, improvements on the land and personal property is less so. More important, real property may be relatively immobile but the people who own that property and are responsible for paying the tax are quite mobile.

Most tax economists recognize that rising property taxes have the potential to encourage flight. The level of property taxation can affect locational decisions, particularly within city-regions that are highly fragmented – surrounded by other municipalities that may offer an alternative locational choice at a lower tax price. In such cases, the tax base itself stays put but the people who pay the tax are leaving. More than a few North American cities have experienced such instances of urban flight and the death spiral that follows it. The threat of a declining and deteriorating tax base is not entirely solved by the immobilty of property. In many respects, the immobility in view here is short-term immobility. Across the short-term, the tax base is immobile. This does not necessarily translate into immobility of the taxpayer over the medium-term or the long-term, which is much less clear.

Further, one has to wonder about the importance of immobility, which is often assumed to be an important factor when it comes to taxation at the local level. But how important is it? The tax reality in Denver, Colorado sheds some light on this question. Property taxes in Denver contribute only about 25% of all local tax revenue while various sales taxes generate almost 60%. If mobility in the tax base is such a big concern, how can Denver possibly get away with this? In fact, how can dozens of cities in some 35 US states get away with local sales taxes that can range upwards of 7%. Is there something else going on here?

There are a number of possibilities. First, taxation is very much a value proposition. If taxpayers perceive good value for the taxes they pay, they have less incentive to change their behaviour and avoid the tax. Second, the rate of tax is an important consideration. Low rates of tax applied to a mobile tax base are less likely to generate economic dislocations. Third, cities are highly integrated centres of commerce. Decisions to move a business outside of a vibrant and bustling commercial centre cannot be taken lightly. Doing so may be quite costly in terms of lost clients and customers, and even higher input costs. Businesses may simply decide to stay put and live with the tax because it is the better alternative.

The relative immobility or mobility of a tax base cannot serve as the single decisive factor in determining what taxes can or cannot be used in the local context. International experience demonstrates that there are ways to deal with mobility issues. For example, applying income and sales taxes across an entire city-region removes much of the opportunity to shift economic activity and prevent destructive tax competition. In the US, many local sales taxes are levied state-wide and "piggy-backed" onto the state sales tax. The state handles administration and collection of these taxes, returns the revenue to local governments based on point of sale and the local tax rate employed. In the final analysis, there is little evidence to suggest that such taxes cannot be made to work in the local context. Immobility may constitute an important theoretical tax concept but its practical impacts may be less important than many assume.

SUMMARY: The unique features of the property tax base have convinced many that it is perhaps the best tax available for local governments. In many respects, this is indeed so. The tax base is broad, easily identified, relatively stable, and quite immobile. However, things are not as cut and dry as they seem. International experience would suggest that there are ways around mobility issues and that they may be less of a concern than originally thought. Stability in the tax base is certainly not guaranteed and it may even be largely irrelevant since political decisions are made all the time to adjust the rate of tax depending on changes in property values. The tax base is relatively broad in the sense that it captures a wide variety of properties, but it is relatively narrow in the sense that it links to only one aspect of the economy – real estate. Finally, there is the ongoing problem of valuation. There is no completely objective measure of the property tax base, which has to be estimated based on a process of assessment.

REVENUE EFFECT

> *"The property tax is based on assessed property values that have a weak relation to ability to pay. Consequently, it is a poor match for funding in the area of income redistribution services, such as social services and housing."* – *Big City Mayors' Caucus (BCMC 2006)*

> *"The chief reason for the continued prominence of the property tax among local government revenues is its stability. It is acknowledged among experts to be the premier tax for a reliable flow of revenue."*
> – *Robert L. Bland (Bland 2005)*

> *It's a stable, predictable tax. Assessed value, the base of the property tax, does not swing up and down as much as income and sales. When it does change, local governments adjust tax rates to guarantee the revenue they've budgeted."*
>
> – Larry De Boer (De Boer 2006)

> *"The property tax simply does not grow to the same extent as personal income taxes or even sales taxes."*
>
> – Douglas J. McCready (McCready 1984)

> *"There is no solid evidence to suggest that there is less revenue generating capacity in the municipal property tax than in provincial taxes. Property tax rates can be increased, although this may be politically suicidal."*
>
> – Harry Kitchen (Kitchen 2001)

1. Revenue Adequacy

■ *Criteria:* Different forms of taxation produce different types of revenue effects. A key consideration here concerns revenue adequacy. In other words, does the tax generate enough revenue at reasonable and comparable rates of taxation? Do the revenues produced meet current expenditure needs? What about future needs? Does the tax match well to the types of expenditures it must fund?

■ *Performance:* Because the property tax is a relatively broad-based tax, it is certainly capable of generating significant amounts of revenue while employing relatively low rates of taxation. This dynamic helps keep any potential negative economic distortions and perverse effects in check. At the same time, local governments in Canada are very heavily reliant on this one tax source. This means that the rate of property tax in Canada is much higher than our competitors in the US and many western European countries. Whether or not this constitutes a distinct competitive disadvantage requires a more detailed analysis than can be provided here, but some have certainly argued the point. The concern here is with comparatively higher levels of business property taxation, much of which constitutes a fixed input cost unrelated to profitability.

A more important consideration relates to whether the property tax is able to generate adequate revenue to meet the current and growing needs of our cities. There is precious little agreement on this matter. Some argue that the property tax is indeed capable but municipal officials have not found enough steel in their collective spine to increase the property tax rate at regular intervals and ensure that sufficient revenues materialize. Others point out that this is easier said than done, and the mere suggestion is tantamount to political suicide for anyone who tries. Still others argue that the whole matter is highly subjective and that there is no real answer. Because the provision of public goods and services occurs outside the free market, it is virtually impossible to determine whether or not an adequate level of service is being provided and whether the tax source used is adequate. Expressed another way, no tax source will ever provide enough revenue to completely satisfy all the demands made on government just as few single individuals ever earn enough personal income to satisfy all their own wants and desires.

At the same time, patches of common ground are emerging on the question. With respect to current expenditure needs, the property tax does not appear to be performing well. The Canada West Foundation conducted a detailed fiscal review of the six big cities in western Canada in 2008. The review showed that property tax revenues have been extremely sluggish. Between 1990-2007, property tax revenues grew only 5.5% in real per capita terms when averaged across Vancouver, Edmonton, Calgary, Saskatoon, Regina, and Winnipeg. This translates into a mere 0.3% real per capita growth annually. Property tax collections relative to personal disposable incomes have also fallen in each and every city. On the other side of the fiscal ledger, real per capita operating expenditure averaged only 3.1% growth over the same time period, or 0.2% real per capita growth annually. Property tax revenues and the services and infrastructure it funds are only barely keeping pace with current population growth and inflation, never mind getting a start on tackling the huge infrastructure challenges facing cities.

With respect to future expenditure needs, there is broad recognition that our urban centres are attracting the great bulk of population growth, and this trend will only accelerate into the future. Canada's large city-regions (census metropolitan areas or CMAs) already contain 70% of the national population and were responsible for almost 90% of all population growth between 2001 and 2006 (Vander Ploeg 2008b). This rapid population growth is increasing the demand for more services, stressing existing infrastructure, and creating the need for billions of dollars in new infrastructure investment. The massive property tax increases required to accommodate all the challenges that come in the wake of this growth are simply not feasible – either economically or politically.

The capabilities of the property tax with respect to urban growth and infrastructure is of particular concern. A good portion of the infrastructure required to accommodate population growth has to be financed and constructed in advance of receiving any property tax revenue from that growth – the full revenue effect of the property tax is often delayed until new property construction is completed. While this revenue lag may simply amount to little more than a short-term cash flow problem, some maintain it can be quite problematic under certain circumstances.

Even more agreement appears to be emerging on whether the property tax is appropriate for all of the expenditures it is required to fund. In many ways a fundamental mismatch seems to be developing between newer forms of municipal expenditure and the property tax. For example, many of our large cities have become responsible for a number of non-traditional municipal functions that possess a strong social element (e.g., immigration settlement, drug abuse, poverty mitigation, urban Aboriginals, homelessness, affordable housing). Most of Canada's social challenges land squarely in big cities, and they are finding themselves increasingly involved in people-oriented services that used to be the purview of federal and provincial governments. While the property tax may be adequate to fund a range of basic services to property, most tax economists are quick to point out that it is ill-suited for social services and the redistribution of income. The reason is that the property tax base itself is unrelated to income, and in that sense, it is too narrow for the job. These types of expenditures are better handled by other forms of taxation that possess a broader tax base.

A separate but related issue concerns current patterns of urban growth and how that affects expenditure, particularly the usage of municipal services and infrastructure. A good portion of urban growth today occurs in metro-adjacent areas – urban and rural municipalities on the fringe of our big cities. Census data show that almost two-thirds of Canada's CMAs have more than one-quarter of their population residing outside the core city. Almost half of Canada's CMAs have more than 75% of their total population growth occurring in metro-adjacent areas. This "donut" growth is increasing the degree of urban fragmentation in Canada. In addition, every big city – regardless of the rate or pattern of population growth – acts as a regional centre providing services and infrastructure to all types of outside visitors whether they be commuters, truckers, tourists, conventioneers, or business travellers.

All of this meets up with a lack of diversity in municipal tax tools to severely press big city finances. The property tax cannot capture revenue from outsiders who nonetheless impose a significant load on municipal services and infrastructure while living elsewhere and paying their residential property taxes elsewhere. Increasingly, the burden of sustaining big city services and the underlying municipal infrastructure is landing on local taxpayers as opposed to all those who actually use the services and infrastructure. To be sure, peripheral growth and visits by outsiders do stimulate the local economy, but this economic stimulus does not always result in additional property tax revenue to city hall, particularly as far as the residential property tax is concerned.

In the past, operating and capital grants used to help address this problem. But in the early 1990s, there was a significant reduction in operating grants to local governments right across the country, and federal and provincial support has yet to return to pre-1990 levels given today's larger urban population and the effects of inflation. Perhaps even more disturbing is how the larger economic rationale for local government operating grants seems to have been lost. Operating grants today appear to be more ad hoc, sporadic, and unpredictable. Given these current trends, problems of "fiscal disequivalence" across city-regions and outside visitors "free-riding" on local services and infrastructure are sure to loom even larger in the future. It is unlikely that the property tax can compete with this. Hiking local property taxes in an effort to maintain services and provide more infrastructure to increasing numbers of those who are not contributing to the residential property tax base is hardly a viable option. This will create even more incentive for an even greater exodus toward the periphery, shrinking the tax base, and requiring even more punitive taxation in the future. It is hardly a solution. Rather, a vicious circle is created.

The entire question of revenue adequacy is all about meeting current expenditure needs, securing modest increases in revenue over time to accommodate the need for growing expenditure, and ensuring that the tax being used is appropriate to the expenditures that it funds. Is the property tax still up to the job? There are more than a few indicators here that the property tax may be faltering – showing itself insufficient to carry the growing burden of funding today's large and modern cities. The question strikes to the heart of local government and local autonomy. It is not enough for local governments to have control over a dedicated tax source. The tax source itself needs to be adequate. Anything less and local autonomy amounts to little more than a cruel joke.

2. Revenue Reliability and Flexibility

■ *Criteria:* This criteria is closely related to adequacy and concerns the stability and predictability of the revenue produced by a tax. Does the tax provide steady and reasonably predictable flows of revenue over time, or does the tax run the risk of producing highly variable flows due to changing economic circumstances? What is the risk of severe fiscal interruption? In addition, can the tax be adjusted to respond to changing fiscal circumstances?

■ *Performance:* If property values and the assessment base are relatively healthy, the property tax tends to produce a very important advantage in the form of reliable, stable, and predictable flows of revenue. Property tax revenues do not surge in response to economic booms nor do they plateau or collapse during times of slowdown. The tax is also reasonably flexible. Because discussions over setting the mill rate occur annually at budget time, there is ample opportunity to increase the amount of tax revenue or decrease it.

Revenue stability is important for several reasons. It provides for a certain level of predictability within the local economy that is highly beneficial for business and the creation of a stable local economic climate. The property tax also helps fund essential urban services – police and fire protection, search and rescue, ambulance and EMS, and public transit. Stability in the flow of revenue ensures that these essential services are not subjected to severe interruption. Stability of revenue also allows for longer-term planning, and is helpful in developing budgets and meeting those budgets. Revenue stability eliminates a lot of the guesswork around public finance.

Revenue stability is largely the function of a relatively stable tax base and the politically-driven nature of the property tax. Once a local government has decided upon the amount of property tax revenue it needs, the mill rate is set at that level and the revenue is virtually guaranteed. Unlike most other taxes, the property tax is the one tax that can be counted upon to bring in exactly the amount of revenue planned. Once citizens and civic leaders have settled on a bundle of services desired for the taxes they pay, the property tax generally delivers. However, this stability is not free. It does come with a price tag. If stable revenue is an important inherent upside to the property tax, then its lack of responsiveness to economic growth is the corresponding downside. This starts us down the road of tax *elasticity* – a subject to which we now turn.

3. Revenue Elasticity

■ *Criteria:* The concept of tax elasticity speaks to how well a tax responds to developments in the larger economy. Taxes that grow alongside the economy are relatively elastic, while taxes that do not are relatively inelastic. Where does the property tax fit in this discussion? What are the implications of elasticity on property tax revenue? Why does elasticity matter?

■ *Performance:* When it comes to elasticity, taxes can be categorized into one of three groups – highly elastic, moderately elastic, and inelastic. Personal and corporate income taxes are the most highly elastic taxes possible. These taxes target income, and it is the sum total of income earned that constitutes the overall size of an economy. Income taxes have a direct link to a broad swath of the economy, and as the economy grows, the revenue from these taxes grows right alongside. Income taxes have built-in escalators that cause the tax revenue to automatically increase without touching the tax rate.

Sales taxes are an enigma – they can be highly elastic, moderately elastic, or quite inelastic. Much depends on how they are structured and applied. A general value-added sales tax applied to a broad base will generally prove quite elastic. An expanding economy results in more goods and services being purchased. Revenue from a percentage-based sales tax will automatically rise due to the increased volume and it always captures the effects of inflation reflected in the prices of the goods or services purchased. Selective sales taxes are a mixed bag. Much depends on the type of good or service in view and whether or not the tax rate is a percentage-based charge or a fixed charge. For example, a percentage-based selective sales tax on restaurants should be moderately elastic but a 5¢ per litre fuel charge will be less elastic. The 5¢ charge is fixed and yields no additional revenue as the price of the good rises. Any additional fuel tax revenue can only accrue from an increase in the volume sold.

When it comes to elasticity, the property tax is a clear bottom-feeder. The reason is simple. The property tax base is relatively narrow in that it links to a limited part of the economy. This tax base also tends to expand and contract slowly. In order to ensure that property tax revenue keeps pace with an expanding economy, growing incomes, and increased consumption, the mill rate has to be intentionally increased.

In the media and the minds of the taxpaying public, any upward change in the property tax mill rate constitutes a tax increase. What is conveniently forgotten is that a portion of this so-called "increase" is merely to account for inflation, never mind increasing the amount of revenue in real dollar terms. In all likelihood, a good part of the "increase" is offset by rising incomes as well. Clearly, this inelasticity places municipal officials at a significant fiscal disadvantage relative to their provincial and federal counterparts. Fearing public backlash, many are hesitant to adjust the property tax rate upwards to ensure sufficient revenue growth. Efforts to counter the effects of this inelasticity produce heated political resistance that can only be overcome by steely resolve. In the absence of that resolve, property tax revenues do not tend to keep pace with economic growth.

Inelasticity is a double-whammy for local governments. Not only does slow growth create a fiscal gap between revenues and the continually growing demands for more municipal services, it also limits the ability of cities to debt-finance some of their urgently needed infrastructure. When revenues expand at a reasonable pace, some of this growth can be leveraged with modest amounts of debt without increasing the interest burden to the operating budget. If revenues grow slowly, the interest that accompanies any increase in debt will consume more and more operating revenue – tightening the revenue squeeze even more and crowding out other priorities. The singular reliance on the slow growing property tax is one reason urban infrastructure in Canada is becoming such a big problem. Unlike local governments in the US that have access to more elastic revenue sources, Canadian cities are singularly reliant on an inelastic tax source that makes borrowing less attractive and more difficult (Burleton 2004).

Inelasticity can hurt taxpayers as well. Unlike income taxes and sales taxes, property taxes do not move along with fluctuations in income or consumption. During an economic slowdown, residential taxpayers face the same property tax liability even though their incomes might be stalling. For business, the property tax liability remains even while profits begin to disappear. For this reason – as well as many more – the property tax is one of the more unpopular taxes.

Historical data can be used to demonstrate the effects of property tax revenue inelasticity *(Figures 8-12).* If tax revenue is keeping pace with economic growth, the tax-to-GDP ratio will be constant over time – a straight trend line. How have various federal, provincial, and local government taxes performed?

Over the last 18 years, federal direct taxation has mirrored GDP growth closely as shown by the relatively straight trendline. In 1990, federal direct taxes represented 12.9% of GDP. This rose slightly to 13.0% in 2007 *(Figure 8, Chart 1).* Direct taxes collected by the four western provinces have also done well. Saskatchewan and Manitoba are collecting slightly more direct taxes as a percent of GDP in 2007 than in 1990, while BC and Alberta are collecting slightly less. However, the provincial trendlines are also relatively flat *(Figure 8, Charts 2-5).*

There is more diversity when it comes to the basket of federal and provincial indirect taxes. Federal indirect taxes as a percent of GDP fell slightly in the early 1990s but then quickly levelled out *(Figure 9, Chart 1).* The experience in Manitoba has been much the same. In both Saskatchewan and Alberta, indirect taxes rose in the early 1990s. They have since fallen and levelled out in Saskatchewan while the trendline is still falling in Alberta. Indirect taxes in BC have stayed relatively constant over the entire time period *(Figure 9, Charts 2-5).* Federal and provincial indirect taxes have tended to undulate more than direct taxes. In the early 1990s, new indirect taxes were introduced and the rates for some existing taxes were increased. This was undertaken to address sizeable fiscal deficits. Since then, some of the rates of tax have been reduced and certain taxes eliminated. In the main, however, the trend lines are still relatively flat.

All of this contrasts sharply with the property taxes collected by large cities in western Canada *(Figure 10.)* Two essential points emerge from the data. First, each city is collecting a significantly lower amount of property taxes relative to its share of provincial per capita GDP in 2007 than in 1990. This holds for each of the six cities. Second, most of the trendlines remain pointed in a downward direction. The bottom line is that the tax revenues collected by the cities have not kept pace with growth in the broader economy, and they have generally not done so since the early 1990s.

This lack of tax revenue growth is compounded by the reduction in federal and provincial operating and capital grants over the same period *(Figure 11).* While grants are moving back to historical levels, they have only recently begun to do so. Operating and capital grants are slightly higher in 2007 as a percent of GDP for Saskatoon and Winnipeg, while they have just barely returned to 1990 levels in Edmonton. Grants relative to GDP are still lower in 2007 than in 1990 for the cities of Vancouver, Calgary, and Regina.

FIGURE 8: Responsiveness of Federal and Provincial Direct Tax Revenue, 1990-2007

CHART 1: Federal Direct Taxes as a % of National GDP (1990-2007)

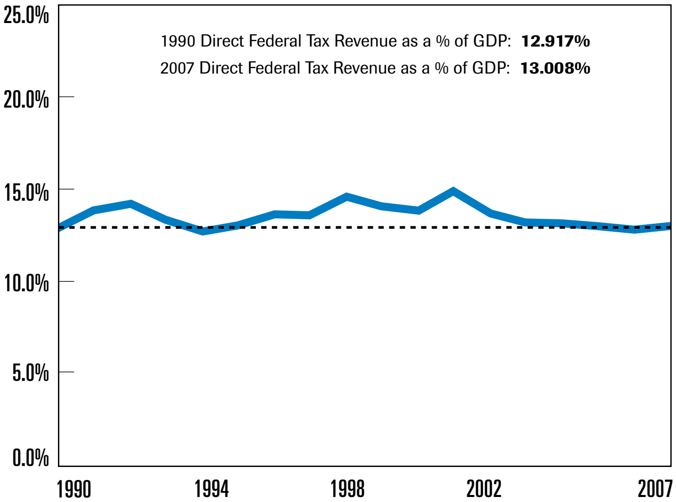


CHART 2: British Columbia Direct Taxes as a % of Provincial GDP (1990-2007)

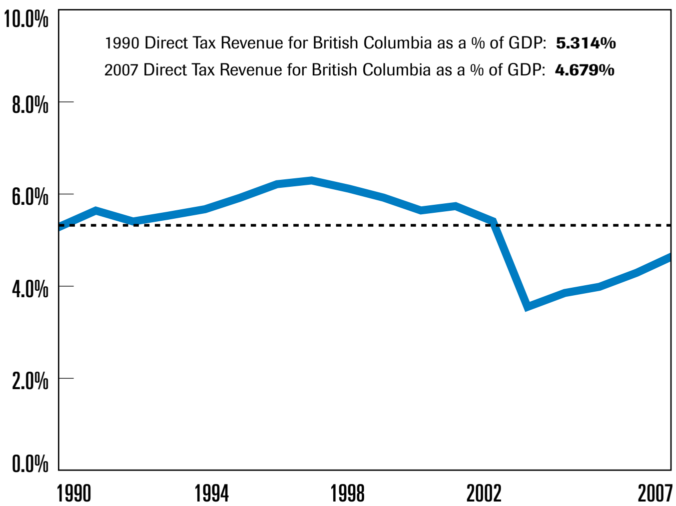


CHART 3: Alberta Direct Taxes as a % of Provincial GDP (1990-2007)

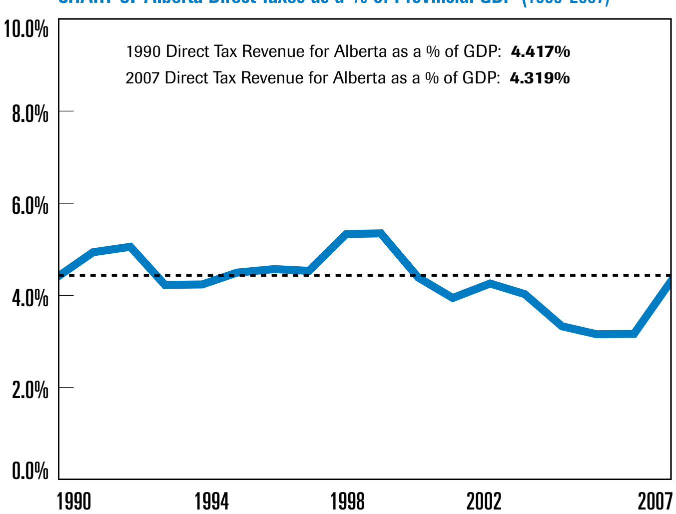


CHART 4: Saskatchewan Direct Taxes as a % of Provincial GDP (1990-2007)

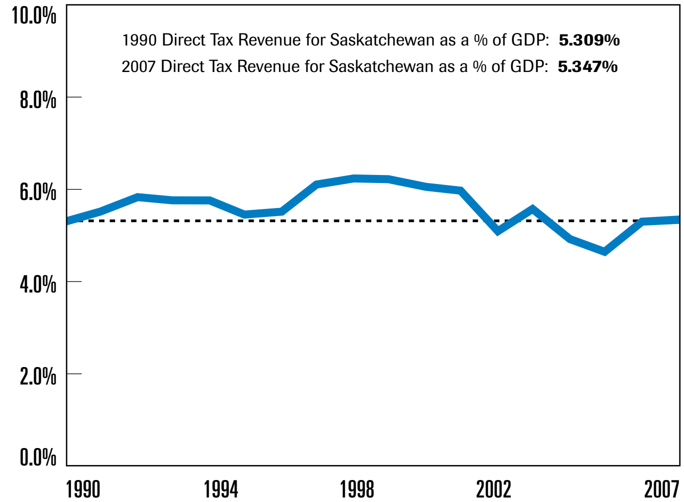
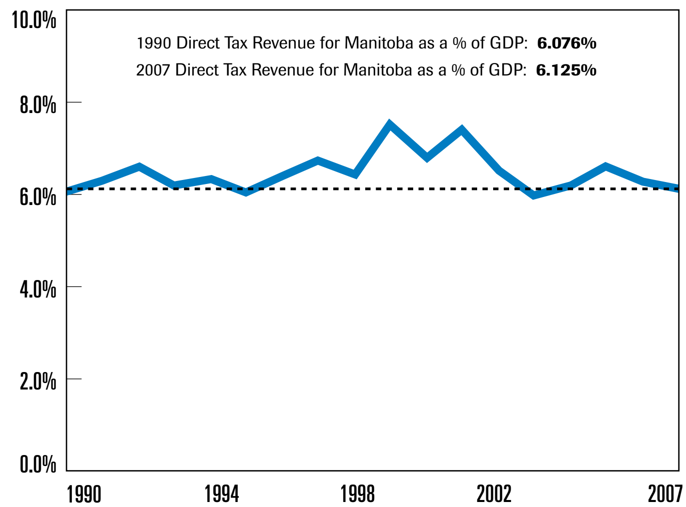


CHART 5: Manitoba Direct Taxes as a % of Provincial GDP (1990-2007)



NOTES:

Federal direct tax revenue in this analysis includes:

- Federal personal income tax
- Federal corporate income tax
- Contributions to the Canada Pension Plan (CPP)
- Contributions to the Employment Insurance (EI) Program

Provincial direct tax revenue in this analysis includes:

- Provincial personal income tax
- Provincial corporate income tax

All revenue amounts were secured from the Public Accounts published by each government for the years 1990-2007. Revenue amounts were then calculated as a percentage of national or provincial Gross Domestic Product (GDP) for each year to produce a tax-to-GDP ratio. GDP data come from Statistics Canada.

SOURCE: Derived by Canada West Foundation from the Public Accounts of the federal and provincial governments (1990-2007), various provincial budget documents (1990-2007), Statistics Canada, and the Dominion Bond Rating Service (DBRS).

FIGURE 9: Responsiveness of Federal and Provincial Indirect Tax Revenue, 1990-2007

CHART 1: Federal Indirect Taxes as a % of National GDP (1990-2007)

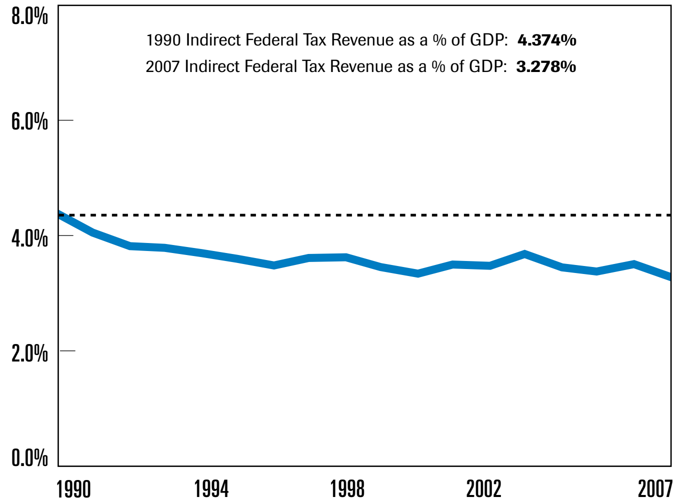


CHART 4: Saskatchewan Indirect Taxes as a % of Provincial GDP (1990-2007)

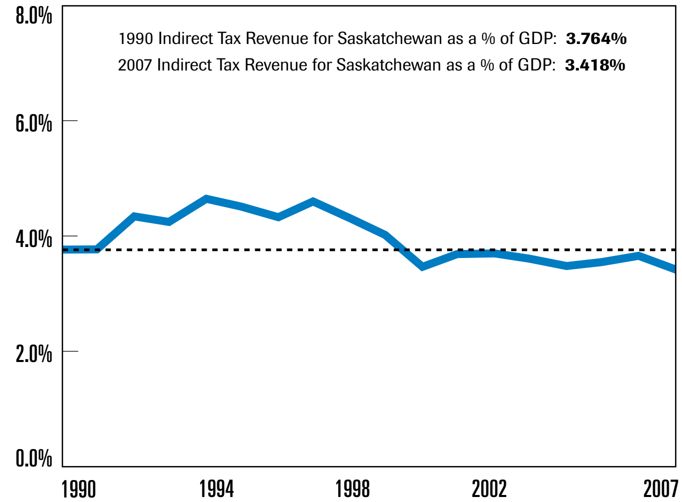


CHART 2: British Columbia Indirect Taxes as a % of Provincial GDP (1990-2007)

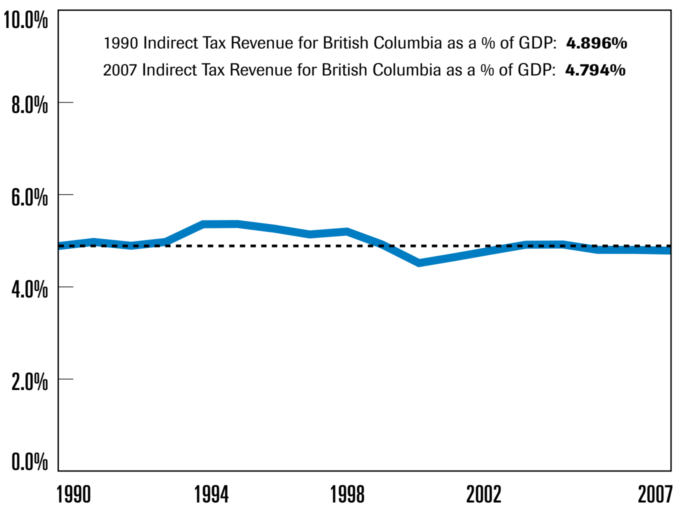


CHART 5: Manitoba Indirect Taxes as a % of Provincial GDP (1990-2007)

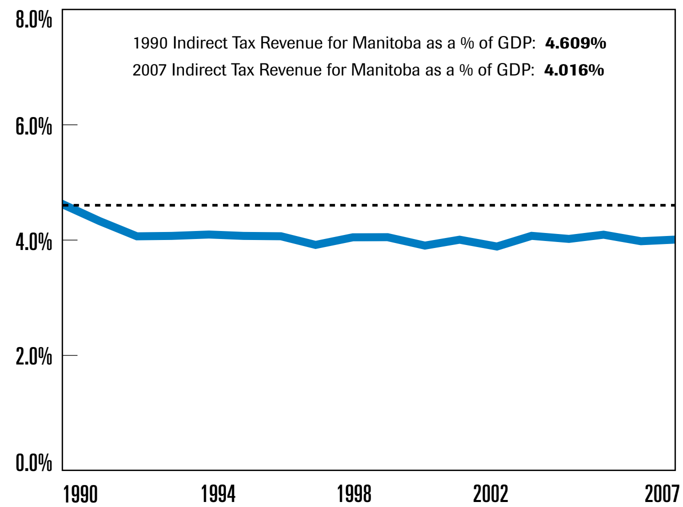
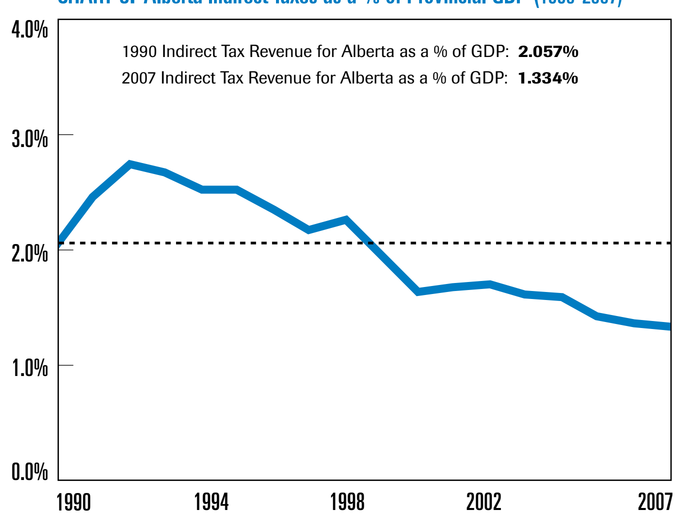


CHART 3: Alberta Indirect Taxes as a % of Provincial GDP (1990-2007)



NOTES:

Federal indirect tax revenue in this analysis includes:
- Federal Goods and Services Tax (GST)
- Federal excise taxes
- Federal import customs and duties
- Other miscellaneous federal sales taxes

Provincial indirect tax revenue in this analysis includes:
- Provincial general sales tax or HST
- All provincial selective sales taxes
- All provincial property taxes (where applicable)

All revenue amounts were secured from the Public Accounts published by each government for the years 1990-2007. Revenue amounts were then calculated as a percentage of national or provincial Gross Domestic Product (GDP) for each year to produce a tax-to-GDP ratio. GDP data come from Statistics Canada.

SOURCE: Derived by Canada West Foundation from the Public Accounts of the federal and provincial governments (1990-2007), various provincial budget documents (1990-2007), Statistics Canada, and the Dominion Bond Rating Service (DBRS).

FIGURE 10: Responsiveness of Municipal Tax Revenues, 1990-2007

CHART 1: Vancouver Municipal Taxes as a % of GDP (1990-2007)

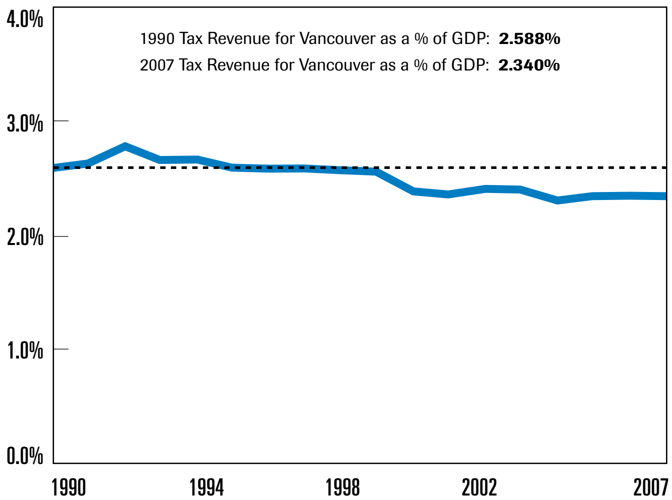


CHART 2: Edmonton Municipal Taxes as a % of GDP (1990-2007)

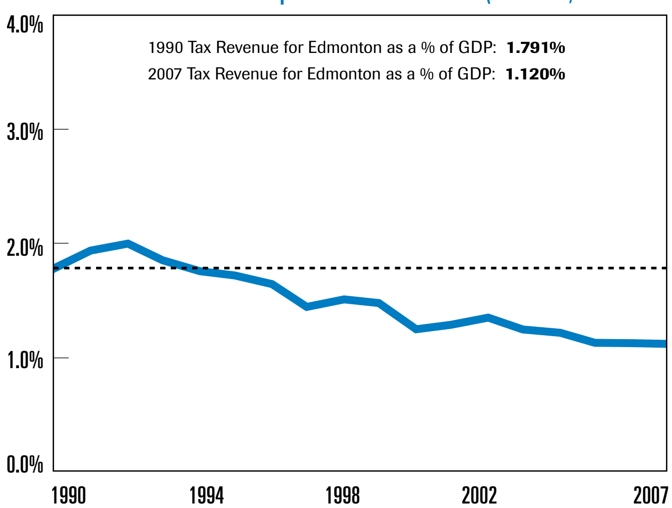


CHART 3: Calgary Municipal Taxes as a % of GDP (1990-2007)

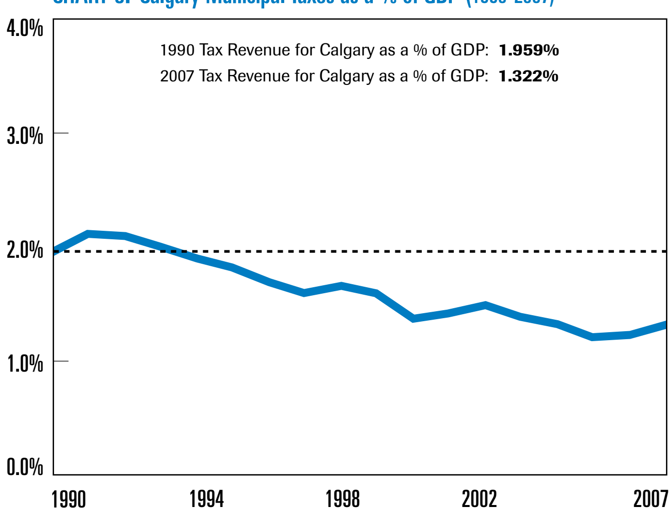


CHART 4: Saskatoon Municipal Taxes as a % of GDP (1990-2007)

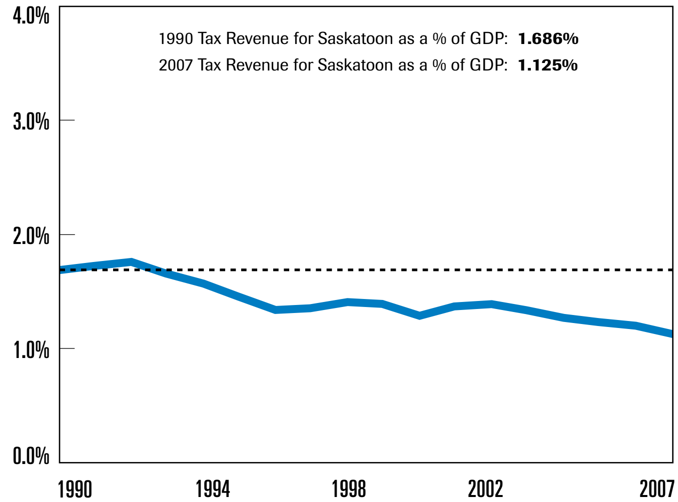


CHART 5: Regina Municipal Taxes as a % of GDP (1990-2007)

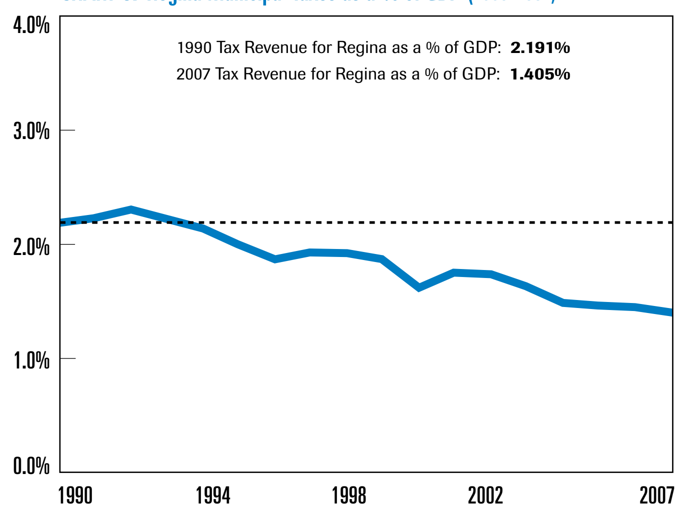
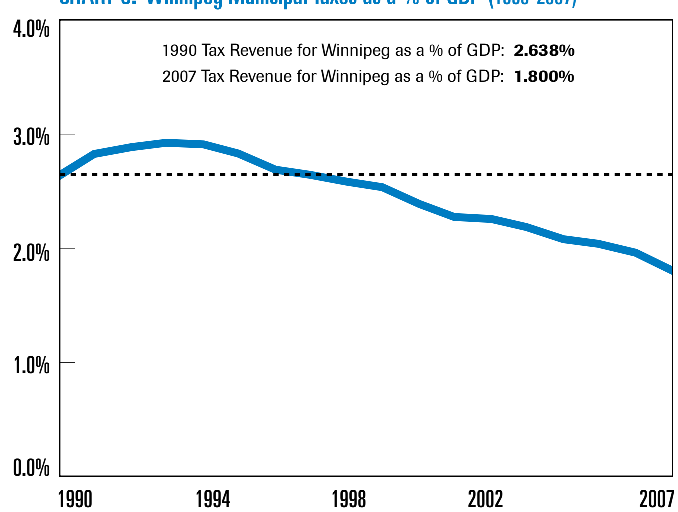


CHART 6: Winnipeg Municipal Taxes as a % of GDP (1990-2007)



SOURCE: Derived by Canada West Foundation from the Annual Financial Reports of the cities (1990-2007), Statistics Canada, and the Dominion Bond Rating Service (DBRS).

FIGURE 11: Responsiveness of Federal and Provincial Operating and Capital Grants, 1990-2007

CHART 1: Vancouver Grants as a % of GDP (1990-2007)

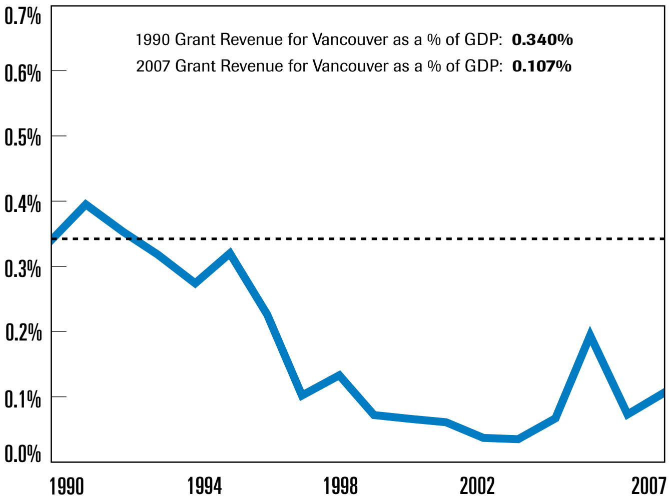


CHART 4: Saskatoon Grants as a % of GDP (1990-2007)

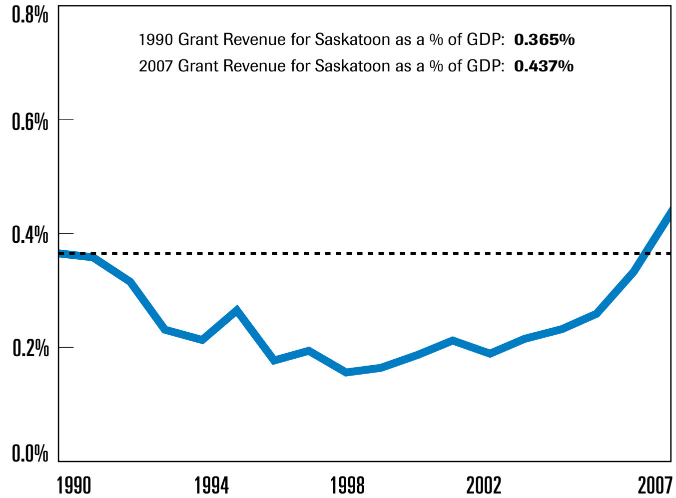


CHART 2: Edmonton Grants as a % of GDP (1990-2007)

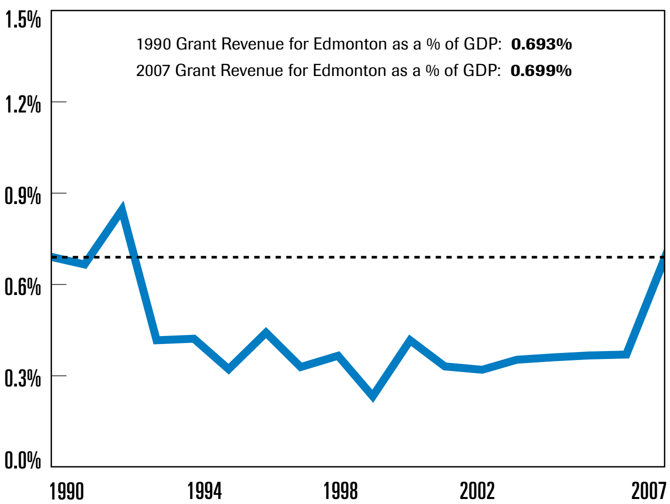


CHART 5: Regina Grants as a % of GDP (1990-2007)

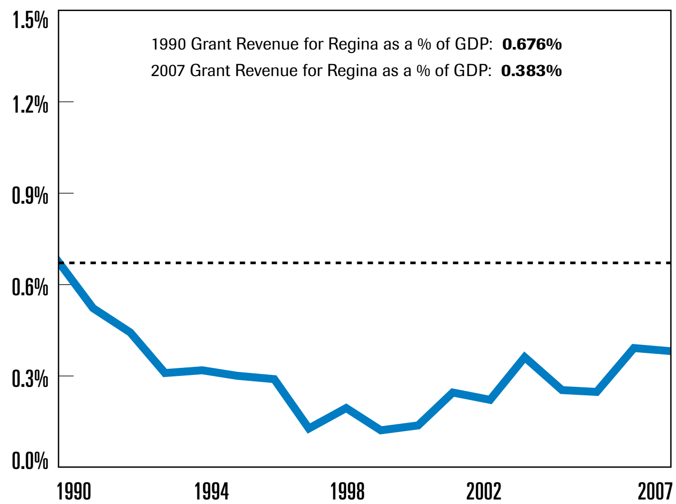


CHART 3: Calgary Grants as a % of GDP (1990-2007)

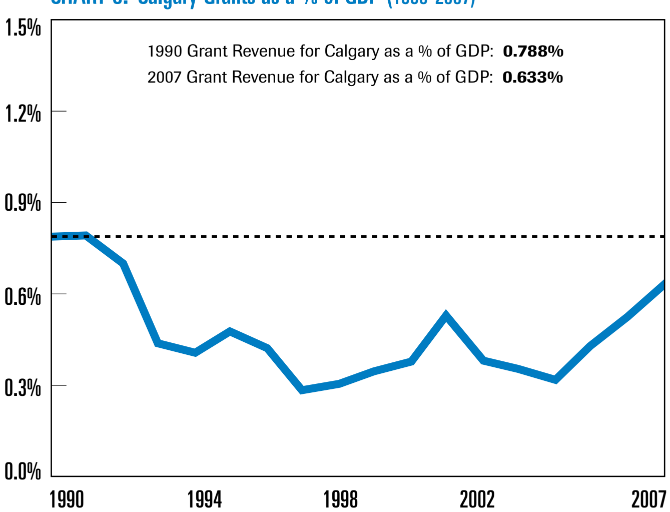
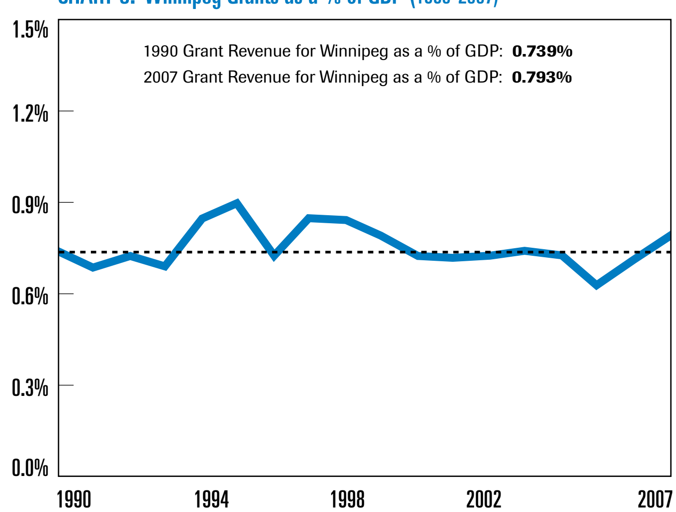


CHART 6: Winnipeg Grants as a % of GDP (1990-2007)



SOURCE: Derived by Canada West Foundation from the Annual Financial Reports of the cities (1990-2007), Statistics Canada, and the Dominion Bond Rating Service (DBRS).

The trendline data can be used to quantify the amount of foregone revenue that occurred in 2007 for each of the six cities due to a lack of elasticity. In other words, how much more revenue would the six western cities have received if taxes and grants had actually kept pace with GDP growth? *Figure 12* presents the results by showing the additional revenue each of the six cities would have collected in 2007 if their tax and grant revenue had kept pace with growth in their per capita share of provincial GDP and had not fallen from 1990 levels.

- *Tax Revenue:* If the cities had collected their 2007 taxes at the same percentage of GDP that they did in 1990, the taxes collected in 2007 would be significantly higher. Vancouver would have collected an additional $65.8 million in 2007 while Calgary would have collected a whopping $486.5 million more.

- *Operating and Capital Grants:* For all of the cities, operating grants would also have been significantly higher in 2007. If operating grants had stayed at the same percentage of GDP as they were in 1990, Saskatoon would have collected an additional $10.0 million in 2007 while Calgary would have collected an additional $263.3 million. With the exception of Vancouver and Regina, most of the cities are actually collecting more capital grants in 2007 than they were in 1990. Clearly, granting has shifted from supporting operations to investing in infrastructure. When the two types of grants are combined, Edmonton, Saskatoon, and Winnipeg are doing slightly better in 2007 than in 1990, while Vancouver, Calgary, and Regina are doing slightly worse.

- *Tax and Grant Revenue:* If taxes and grants had not fallen as a percent of GDP but stayed consistent like federal and provincial direct and indirect taxation, all of the cities would be collecting significantly more revenue. Vancouver would have collected an additional $128.1 million in 2007 alone. Edmonton would have collected an additional $386.6 million in 2007 while Calgary would have collected an additional $605.0 million.

The inelastic nature of the property tax, combined with reductions in intergovernmental transfers, have shorted the western Canadian cities of significant revenue. The cities have not been able to use the property tax to secure an ongoing and consistent share of the economic growth occurring within their boundaries. This is highly problematic. The cities have experienced significant population and economic growth since 1990, and accommodating this growth is costly. To be sure, a growing population and economy is not ordinarily problematic for governments – it should lead to increased tax revenues which can be used to help fund the increasing costs *(Discussion Box 2)*. But the cities are highly dependent on the inelastic property tax. They do not have at their disposal a diverse set of taxes to capture the increased tax revenue that normally accrues from such growth. When it comes to population growth and economic expansion, federal and provincial governments appear to get the upside – the goldmine – while the cities get the downside – the shaft.

SUMMARY: Defenders of the property tax argue that the tax is adequate given local expenditure responsibilities. However, this ignores the fact that local government responsibilities have expanded well beyond traditional services to property owners. Local governments now deliver a wide range of "people-oriented" services that can involve a strong income redistribution component. For these areas, the property tax is inadequate. Furthermore, the property tax cannot collect revenue from a host of outsiders who use city services and infrastructure but pay their property taxes elsewhere. This is causing a portion of the burden of financing our cities to land disproportionately on local property taxpayers. The revenue produced by the property tax is generally stable and reliable. While this is often touted as an advantage, it carries a huge cost in that the tax revenue is relatively inelastic. While stable revenue flow is certainly desirable, this cannot be allowed to completely sidetrack adequate revenue growth over time. The property tax and grant experience of the West's six largest cities appears to indicate that such sidetracking has indeed occurred.

FIGURE 12: 2007 Revenue Loss Due to Inelasticity
(Six Western Cities in Actual Nominal Amounts)

	VANCOUVER	EDMONTON	CALGARY	SASKATOON	REGINA	WINNIPEG
2007 Foregone Tax Revenue	$ 65,838,000	$ 389,781,000	$ 486,470,000	$ 59,389,000	$ 73,303,000	$ 224,232,000
2007 Foregone Operating Grant Revenue	$ 61,256,000	$ 156,460,000	$ 263,258,000	$ 10,028,000	$ 21,200,000	$ 14,049,000
2007 Foregone Capital Grant Revenue	$ 1,018,000	$ (159,673,000)	$ (144,729,000)	$ (17,648,000)	$ 6,150,000	$ (28,565,000)
2007 Foregone Tax and Grant Revenue	$ 128,112,000	$ 386,568,000	$ 604,999,000	$ 51,769,000	$ 100,653,000	$ 209,716,000

SOURCE: Derived by Canada West Foundation from the Annual Financial Reports of the cities (1990-2007) and Statistics Canada.

DISCUSSION BOX 2:
Edmonton Elasticity Example

In 2006, median family income in Edmonton was $79,300. A two parent family with one income earner and two dependent children would have paid total federal and provincial income tax of $17,005 on this income. Income taxes were thus 21.4% of income. In 2007, median family income is estimated at $85,900. The income tax payable on this income was $17,953. Taxes were thus 20.9% of income. Between 2006 and 2007, the average Edmontonian family paid an additional $948 in federal and provincial personal income tax even though the tax-to-income ratio fell from 21.4% to 20.9%. Clearly, income taxes are highly elastic.

Shifting to the municipal perspective tells a much different story. In 2006, an Edmonton family living in an average single-family home paid $1,259 in municipal property tax. In 2007, an average family in an average home paid $1,376 in municipal property tax — a $117 or 9.3% increase. What is often forgotten is that most of the $117 increase was offset by rising disposable incomes. In 2006, the $1,259 property tax bill was paid out of $62,295 in personal disposable income that remained after paying federal and provincial income tax. Thus, property taxes were 2.021% of personal disposable income. In 2007, the $1,376 property tax bill was paid out of $67,947 in personal disposable income. In 2007, property taxes were 2.025% of personal disposable income.

Even though the ratio of municipal property tax to personal disposable income rose slightly, it resulted in little additional revenue compared to the federal and provincial tax take. If the 2006 ratio of 2.021% were in play in 2007, the family's property tax bill would have been $1,373 rather than $1,376. Thus, the *effective* property tax increase in 2007 relative to personal disposable income was $3 — a mere 25¢ per month.

In 2007, property taxes in Edmonton did increase relative to personal disposable income, but the actual "increase" here resulted in very little revenue. On the other hand, personal income taxes relative to gross incomes fell, but still resulted in a $948 windfall for the federal and provincial governments.

Property taxes are inherently inelastic, unless governments intentionally and dramatically increase the rate of tax over time. Such increases are immensely unpopular because they are seldom viewed alongside the income side of the equation.

But in the end, who is taxing whom and how much?

ECONOMIC EFFECTS

"Whether the property tax is examined under the benefit principle or the ability to pay principle, the property tax does not perform very well."
– Douglas J. McCready (McCready 1984)

"The study concluded that the non-residential sector is over-taxed and the residential sector is under-taxed. This is inefficient because users are paying for services they do not consume or using services for which they do not pay. In either case, the optimal level of output will not be achieved. It is unaccountable because there is no direct and clear-cut link between the cost of the service consumed and payment for it..."
– Harry Kitchen (Kitchen 2004b)

"Several empirical studies confirm that the property tax reduces the density of development."
– Enid Slack (Slack 2002)

"Property tax is a capital tax. Capital taxes kill jobs. Corporate capital tax is being eliminated. The tax on family capital – homes, farms, and businesses – continues to increase." *– Association of Saskatchewan Realtors (2008)*

1. Equity

- *Criteria:* Equity or fairness in taxation is critically important when evaluating any tax. When it comes to taxation, there is widespread agreement – and rightly so – that taxes should treat everyone fairly. Not only is this criteria of fundamental importance in its own right, issues of equity have ramifications that ripple out and affect the performance of the tax on many other criteria such as transparency, accountability, and public acceptance of the tax. At the same time, equity is tricky because perceptions of fairness vary and the matter itself is so multi-faceted. How well does the property tax score on equity?

- *Performance:* A number of tax equity concepts must be clearly understood right at the outset. Broadly speaking, there are two basic principles of tax equity – the benefits principle and the ability to pay principle. The *benefits principle* asserts that those who benefit from the services provided by a tax should be the same ones responsible for paying the tax. Further, the amount of individual tax paid should approximate the individual benefits received. The *ability to pay principle* ignores these considerations and asserts that a tax can be considered equitable if people are taxed according to their ability to pay the tax. In other words, those with higher income or wealth pay more tax while those with lower income or wealth pay less tax.

While the benefits principle is straightforward, the ability to pay principle gives rise to several other concepts of tax equity. For example, the concept of *horizontal equity* addresses the concern that taxpayers in similar circumstances pay similar amounts of tax. The concept of *vertical equity* speaks to the concern that those in differing circumstances pay differing amounts of tax according to the degree to which their circumstances actually diverge. The concern of horizontal and vertical equity is that individuals are treated uniformly.

When it comes to equity in taxation, a lot of the popular discourse spins around whether a tax is *regressive, proportionate, or progressive.* Unfortunately, these terms are often bandied about carelessly. First, each of these descriptions is really a subset of the horizontal and vertical equity concepts under the ability to pay principle. Second, the terms describe how various taxes treat people of unequal means, with the essential focus falling on the effective rate of tax. A regressive tax is one where the effective rate of tax is higher for those with lower affluence. A proportional tax levies a similar tax rate across the board. A progressive tax sees tax rates rise along with levels of affluence.

To demonstrate, we can look at a tax on cigarettes. This tax is a proportional tax – the rate of tax is the same for each package of cigarettes purchased. In this sense, the tax is horizontally equitable because all smokers are treated the same. However, a $5 dollar tax on a package of cigarettes means more to a low-income smoker than a wealthy smoker. So the net impact of the tax falls more heavily on those with lower income. But this does not make the tax regressive. The overall effect or impact may tend toward regressivity, but the tax itself is very proportional.

How do all of these equity principles and concepts work when considering the property tax? While such attempts are rare, some have tried to defend the property tax based on ability to pay considerations. The underlying assumption is that the value of property owned is a good proxy for income, and therefore, ability to pay. In some instances this may well be the case, but in others it is clearly not. For example, a family might purchase a home with manageable property taxes only to see those taxes increase and eventually outpace their income with the passage of time. The fact that property tax liabilities can continue to increase while income shrinks makes the tax especially difficult for some – particularly senior citizens, those on fixed incomes, or those with low income.

A good measure of affluence is income or consumption, and taxes based on these tend to score well in terms of ability to pay. But the property tax does not link directly to incomes earned or spent. It relates to income indirectly via ownership of a capital asset. This asset may or may not reflect ability to pay. In response, some have argued that the value of property owned is still a good reflection of lifetime income. When considering someone's ability to pay, lifetime income is just as reasonable as current income. But the practical reality is that annual property taxes must still be paid out of current income and not income that has come and gone 20 years ago. Also, while property tax payments can be viewed as spreading out across an entire lifetime, this would by necessity also include a period when the taxpayer actually owned no property. Implicit in the argument is the suggestion that those with little current income and few savings should sell property to lower their property tax liability. And property taxes are often accused of this very thing – the cause of grandmothers being forced out of their homes. It is this very rhetoric that shows the lack of connection – in certain instances – between the property tax and ability to pay.

When examining the property tax against horizontal and vertical equity considerations, it is clear that similar properties in a similar area should be treated the same while different properties would have property tax differentials proportionate to the difference in their underlying market value. But none of this can be guaranteed given the lack of a purely objective measure of property value – assessors can and do sometimes arrive at quite different values when looking at the same property.

Further confusing matters is widespread disagreement about the regressivity, proportionality, and progressivity of the property tax when viewed against income. Conventional wisdom and popular opinion certainly asserts that the property tax is a regressive tax and it is often vilified on this basis. But a lot depends on the type of property in question, the assessment practices in place, and the availability of tax credits, rebates, refunds, deferrals and other such "circuit-breakers" for those with low incomes. Ultimately, regressivity is highly dependent on the local circumstances in play. Some tax economists have argued that the property tax is likely regressive at low income levels, proportional at middle income levels, and even progressive at high levels of income. However, broad consensus has not been reached. Many studies indicate that the property tax is indeed regressive, but newer economic models suggest that this regressivity may be overstated. In short, the jury is still out the matter (Harriss 1974; Lorelli 2001).

Given all of the above, most tax economists are prepared to concede the equity point under the ability to pay principle and defend the property tax based on the benefits principle – those who own property benefit from the services to that property, and therefore, should pay the tax used to fund those services. How well does the property tax score here?

At first glance, the property tax might seem to score better under this measure of equity. Because real property and those who own it are relatively immobile over the short-term, this ensures that all property owners contribute to the total cost of providing services to those properties. The tax is equitable if only because all property owners are paying for the benefits that accrue from the services financed by the tax. Thus, the benefits principle seems reasonable when viewing the flow of taxes and benefits that occur within a local community. But all of this is far from an open and shut case.

First, when it comes to equity and individual property owners, the basic assumption underlying the benefits principle and the property tax is that there is an approximate relationship between the assessed value of a property, the amount of local public services consumed, and the costs of providing those services to the property. But this relationship is tenuous at best. The property tax payable does not always reflect the variable costs of providing services and infrastructure to individual properties, which is more likely to vary based on some other factor such as location rather than assessed value. The property tax – just like every other tax – forces everyone to pay regardless of whether they use a service or not and the amount of tax does not generally reflect the variable costs of providing those services.

Second, the benefits principle is severely weakened by current administration of the property tax. Of particular concern here is the discrimination in assessed values or the differential rates of tax applied to different classes and categories of property. The property tax is seldom applied uniformly across all properties, which often carry different effective rates of taxation. These intentional differential effective property tax rates are not based on the usage or cost of municipal services and infrastructure.

Third, the benefits that accrue from local government services and infrastructure are simply not limited to local property owners and taxpayers. The fact is, a lot of local government expenditure – particularly in the large cities – is more regional in nature. As noted earlier, cities continually draw visitors from the outside who benefit from the services and infrastructure provided, but pay their residential property taxes elsewhere. This "free-riding" on local taxpayers and "fiscal disequivalence" across large city-regions is just one more obvious area where the link between benefits received and taxes paid is broken.

When it comes to the property tax and the benefits principle, the basic assumption appears weak, current administration of the tax works to undermine it, and it simply does not reflect the practical realities of who is paying and using local government services and infrastructure. The fact that the property tax does not score well under either the ability to pay principle or the benefits principle has opened the property tax up to the serious charge that it violates basic principles of fairness and equity. And this has ramifications that spill over and create a whole set of new problems.

2. Allocative Efficiency

- *Criteria:* Whenever government expenditures are funded through taxation, there is a risk of misallocating public resources. Only when the consumers of a good or service are required to individually pay will the right amount of various goods and services be provided. Anything less implies a certain amount of inefficiency, waste, and a net loss to society. How does the property tax encourage or discourage the efficient provision of local government services and infrastructure?

- *Performance:* It goes without saying that all taxes by necessity must result in a certain loss of efficiency. This is unavoidable and property taxes are no exception to the broader rule. However, it would be a mistake to simply accept this as a fact of life and move on. Why? Because the property tax does have – at least in theory – a certain amount of potential to promote efficiency in the delivery of local government services and infrastructure (Kitchen 1993). The problem here is that the tax is currently administered and applied in ways that work against attaining such efficiencies. Briefly stated, current administration of the property tax essentially cross-subsidizes services and infrastructure, leading to waste, artificially increased demands for more services and infrastructure, and total higher costs of local government. We are not talking here about inefficiencies inherent to the property tax – that comes later – but inefficiencies that result from intentional inequities created by application of the tax.

It is commonplace across Canada for differential effective rates of property tax to be applied to different categories and classes of properties. It is well-known that non-residential properties are over-taxed relative to residential properties. Within the residential category, multi-family residential properties are typically taxed at higher effective rates than single-family residential properties. Newer properties tend to be over-taxed relative to older properties and land values have historically been under-taxed almost everywhere (Kitchen and Slack 1993; UNSM 2001; Kitchen 2000; McCready 1984). Again, most of this is intentional and none of it relates to capturing the variable costs of providing municipal services and infrastructure to these properties. In fact, it is sometimes the case that those who consume fewer services are paying higher effective rates of tax. For example, multi-family housing in a dense neighbourhood requires less infrastructure and ongoing expenditure to maintain that infrastructure than single-family housing that is more geographically spread out. Yet at the end of the taxation day, multi-family properties are paying higher effective rates of property tax.

Certain taxpayers then – simply by virtue of the type of property they own – are being forced to subsidize other taxpayers who get a "free" ride. Individuals who consume fewer municipal services, or for whom the costs of providing those services are lower, can end up subsidizing those who consume more services or for whom the services are more expensive to provide. This results in waste, perverse economic incentives, cross-subsidization that redistributes incomes and benefits, increased consumption, artificial demands for more infrastructure and services, higher total costs, and a loss of accountability (Groot 1995). If the real nature and effect of this redistribution were known, many would find it completely unacceptable (Kitchen 2002). Why? Because taxing lower income residents of a multi-family complex at a higher effective rate so that the relatively more affluent owners of single-family homes can play "subsidized" golf in the suburbs and drive on city roads for "free" does nothing to promote the efficient provision of services, not to mention its perverse redistribution of incomes and benefits.

Some argue that all of this could be avoided and the property tax reformed to ensure more equity and allocative efficiency. Others are not so sure. Part of the problem relates to the political environment in which the property tax operates. There is a reason why business properties are over-taxed — residents vote and businesses do not. The darker underbelly to all of this is how the relatively meek and mild property tax starts looking more and more like a capital tax *(Discussion Box 3).*

3. Neutrality and Distortions

■ *Criteria:* No tax is entirely fair or completely neutral with respect to investment patterns, economic distortions, or decisions about location and business inputs. Every tax produces at least some deadweight loss and has the potential for creating undesirable effects within the broader economy. What are some of the distortions inherent to the property tax? How problematic are these distortions?

■ *Performance:* When it comes to assessing the impact of a tax on the broader economy, the standard rule is "no tax is a good tax but some taxes are worse than others." For example, it is generally agreed that a broad-based general sales tax constitutes one of the better forms of taxation. Sales taxes target consumption as opposed to income, and can also be structured in ways to limit regressivity and do so without compromising incentives for investment. This is one of the reasons why value-added general sales taxes have become increasingly popular, particularly in western Europe. On the other hand, a corporate capital tax is arguably one of the worst taxes possible.

Across the literature, there seems to be broad agreement that a well-designed and properly applied property tax will have some impact on decisions and behaviour within the larger economy, but it likely creates less mischief and harm than many other taxes. This is particularly the case when property taxes are compared to personal and corporate income tax (Mintz 2001). As such, some have argued that the property tax is well-suited for the challenges of the 21st century *(Discussion Box 4).* Again, the key here is that the amount of property tax levied has a logical connection to the costs of municipal services and infrastructure provided. To the extent that this occurs, the neutrality of the property tax is improved upon and undesirable distortions are avoided.

Without flooding the discussion in too much detail, it is worth considering three points when it comes to the neutrality of the property tax. First, the singular and relatively heavy reliance of Canadian cities on this one tax may increase its potential to produce more and heavier distortions. The distortive effects of any tax are arguably amplified when the rate of tax is relatively high and the tax operates alone. It is generally better to have the distortions inherent in one tax offset by the presence of other taxes (Kitchen 2000). While the broader tax environment at the federal and provincial levels may help, the point remains that a relatively heavy dependence on one tax does increase the risk of more distortions.

DISCUSSION BOX 3:
Is the Property Tax a Capital Tax?

"The Saskatchewan Chamber of Commerce continues to advocate for the simplification and reduction of the property tax burden in the province, arguing that property tax is a capital tax that acts as major disincentive to investment and migration."
— Saskatchewan Chamber of Commerce (2008)

"Capital taxes are particularly difficult for a business to manage. Unlike profits taxes, royalties, or even sales taxes, they have no relation to income, ability to pay, or behaviour. Capital taxes subtract a portion of the income-generating asset's value — destroying investment and productivity." *— Association of Saskatchewan Realtors (2008)*

"Of particular concern is the question of how to best view the local property tax — as a fee for public services or as a distorting tax on capital." *— Svante Mandell (Mandell 2001)*

Capital taxes target the built-up capital — primarily debt and shareholder equity — of business corporations. While the particulars of such taxes can differ, they generally require corporations to pay an amount of tax based not on revenue or profit earned, but on their short and long-term debt, equity, capital stock, retained earnings, reserves, and accumulated surpluses. Capital taxes essentially target the savings and investment pool of business — the very fuel that drives the engine of economic growth, innovation, and productivity. As such, most economists argue that capital taxes are among the worst taxes possible, discouraging business investment and damaging economic growth (Clemens 2002).

While there is certainly no consensus on this point, the property tax is increasingly being viewed as a tax on capital, and advocates of this position are becoming more vocal. The "old" view sees the property tax as a benefits-based tax while the "new" view now emerging sees the property tax as a distorting tax on capital. The difference between "old" and "new" turns on the basic economic assumptions used when evaluating the tax, particularly whether people and capital in the local economy are relatively mobile or immobile. There has been some theoretical musings on this point, but few empirical studies. As such, the matter remains generally unsettled (Mandell 2001).

But discussions about equity do provide some helpful guidance. It is generally conceded that the property tax is not a tax based on ability to pay. Further, it is clear that the property tax does not always function as a benefits-based tax where the amount of tax paid equates to services received. If neither of these two equity principles apply, then the only option left may be to view the property tax as a distortionary tax on capital (Slack 2001).

For example, it is well-known that non-residential property is over-taxed relative to residential property — the amount of property tax collected from the non-residential sector far exceeds the cost of city services and infrastructure consumed by the non-residential sector. This difference between the taxes paid and the value of services received amounts to a fixed input cost unrelated to the consumption of services (benefits received) or profit (ability to pay). It is this component of the property tax — the difference between taxes paid and benefits received — that amounts to a tax on capital. Just like any capital tax, this over-taxation of non-residential property leads to a less competitive business climate, lower levels of economic activity, reduced output, and fewer jobs (Kitchen 2004a).

The residential portion of the property tax is different. As a group, these properties are under-taxed relative to the services and infrastructure consumed. Thus, there is less justification for viewing the residential portion of the property tax as a capital tax. But individual residential property owners can still pay more property tax relative to services consumed. Does this difference constitute a tax on capital as well? Strictly speaking, it does not. Investment in owner-occupied and rental housing uses "unproductive" capital while business investment is "productive" capital. However, others have responded that the individual "unproductive" capital invested in residential property is often used as collateral to backup the starting of new businesses, and in that sense, it may be more "productive" than generally acknowledged.

In the end, the fact that the property tax does not perform well on the ability to pay principle or the benefits principle means that the tax certainly has the potential to act as a highly counterproductive capital tax. On that basis alone, Canadians should be concerned about having local governments so dependent on this one tax source.

DISCUSSION BOX 4:
A Horse and Buggy Tax?

Basic administration of the property tax has not changed much over the years, but the nature of the world economy has certainly changed. Does the property tax still makes sense in a globalized information economy?

Increased global economic integration places a premium on competitiveness, not only in the private sector but across the public sector as well. If the public sector is not operating as efficiently as possible, the effects will certainly spillover into a less competitive private sector. With increased globalization, governments need to have a competitive tax system, one that keeps taxes as low as possible but also employs taxes that are efficient. Seen from this perspective, property taxes may be a good choice particularly when compared to more distortive taxes like income taxes or corporate capital taxes (Mintz 2001).

But in many ways, the property tax does not always provide a good fit, especially when considering the commercial and industrial sector. The size of a property or building does not always bear a direct relation to the level of economic activity taking place, business is over-taxed relative to the services they consume, the property tax is unrelated to profit and thus constitutes a fixed input cost, and in some big cities, all of this is aggravated by a special business occupancy surtax.

In addition, the transition to a knowledge-based information economy may be weakening the traditional link between property ownership and wealth creation — no longer is the ownership and usage of real property a key to generating income or wealth. Today's highly-skilled workers and creative entrepreneurs are footloose. They can locate almost anywhere in the world and still do most anything an information economy requires. It is not inconceivable to be working poolside in San Diego with a laptop and a wireless Internet connection, drawing income from a long distance business relationship with clients in Edmonton or Saskatoon.

While evidence concerning the wider impact of these new trends has yet to emerge, some cities are expressing increased concern about a declining commercial and industrial property tax base. This carries with it the threat of an even higher relative property tax burden for existing business since it has always proven politically difficult to increase the property taxes paid by residential taxpayers. The current share of property taxes paid by businesses — already disproportionate to the services and infrastructure they use — could well rise, leading to even greater concerns with the efficiency and distortions of the property tax.

Second, it should be clearly recognized that the property tax targets both the supply and the quality of housing within the local economy. Whenever governments tax a good or service, the tax results in a disincentive to produce, consume, or exchange that good or service. It is quite likely that the property tax can and does discourage investment in housing. It may also discourage investments aimed at improving the quality of housing since such efforts can result in higher property taxes. To be sure, the interactions here are complex. However, it is interesting to note how more and more cities in Canada are struggling to cope with issues of affordable housing all the while they rely on the one single tax source that can be said to work against the supply of housing. This practical consideration has led some to argue that the current property tax system be scrapped in favour of a more neutral land tax or site value tax *(Discussion Box 5).*

A third area of concern relates to patterns of development and ongoing concern over the impacts and costs associated with urban sprawl. Many of Canada's big cities continue to struggle with the effects of urban sprawl, which increases the cost of services from roads and street lighting to pumping water and removing waste, not to mention the increased demand for municipal infrastructure such as roadways and expanded transit. It is becoming increasingly evident that big cities lack effective tools to contain this fiscally and environmentally destructive growth pattern. The drivers of urban sprawl are many, and include relatively cheap land on the periphery, current zoning practices, the relatively low cost of automobile transportation, rising living standards, and the preferences of individual homeowners. But one factor that is often ignored is the role the property tax may be playing (Slack 2002).

All of this goes back to the equity issues discussed earlier. For example, residential properties "closer-in" to the city core are usually more expensive and carry higher assessed values. Thus, these properties must pay higher effective rates of property tax than similar properties in the suburbs. Yet, the costs of providing municipal services and the attendant infrastructure to suburban properties are arguably higher (Vander Ploeg 2004). Again, when properties of similar type are assessed the same regardless of the costs of service provision, a system of cross-subsidization is created. Here, those living "closer-in" are called upon to help cover the costs for those living "further-out" on the periphery. This breaks the link between property taxes paid and the actual benefits of municipal services and infrastructure received, and can reinforce sprawl (Slack 2002).

DISCUSSION BOX 5:
Land Tax or Site Value Taxation

"If you build a nice home in the city, one of your first visitors will be the tax assessor. The tax you will have to pay is the penalty for improving the city. The nicer the house, the higher the penalty. Does this make sense to you? A tax on buildings discourages building. A land tax encourages building. It's one of those mind-bogglingly simple ideas that never gets the attention it deserves." — *Diane Lucidi (Lucidi 2008)*

"Pennsylvania's pioneering approach to property tax reform recognizes this important distinction between land and building values through what is now known as the split-rate or two-tier property tax. The tax is decreased on buildings, thereby giving property owners the incentive to build and to maintain and improve their properties, and the levy on land values is increased, thus discouraging land speculation and encouraging infill development. This shifting of the tax burden promotes a more efficient use of urban infrastructure, such as roads and sewers, decreases the pressure towards urban sprawl, and assures a broader spread of the benefits of development to the community as a whole." — *Alanna Hartzok (Hartzok 1997)*

What is a Land Tax?

A land tax or site value taxation removes all improvements from the property tax and taxes only the assessed value of the land portion of residential or business property. The idea represents a fundamental departure from current property tax practice, which taxes both the value of land and improvements equally. The compromise position between the two is the split-rate tax, two-tiered property tax, or the differential mill rate tax. Split-rate taxation targets the land portion of property at a higher rate than the improvements sitting on the land.

What are the Advantages?

According to its proponents, site value taxation offers the potential to limit some of the negative distortions produced by the current property tax. First, site value taxation allows property owners to improve their properties without having to pay more property tax. Thus, the tax is said to provide an incentive for more investment in residential and commercial development, and better maintenance of those developments over time. The tax is thought to be more neutral with respect to the supply of housing, and more neutral with respect to the quality of that housing as well.

Second, when land and improvements are taxed equally, there is little incentive to make improvements to under-developed or under-utilized land. Such systems of taxation create low holding costs for land, encourage speculation, and push development out to the urban fringe. However, when land is taxed at a higher rate than the improvements sitting on top of it, the relative cost of holding vacant or under-utilized land rises appreciably. To lower their tax liability, owners will make improvements. This happens because those with significant improvements on their land pay the least amount of tax relative to the total value of both the land and improvements they own, while those holding vacant or under-used land pay relatively more. In other words, site value taxation favours the highest and most intensive use of land to lower the relative amount of tax paid.

In theory, then, site value taxation should encourage more dense development, promote inner city revitalization, and help curb urban sprawl. Taxing land only moves the property tax burden away from investment and toward the owners of unproductive, vacant or under-utilized land. It motivates owners to convert property to its best and highest use (Holle and Owens 2002). To the extent that site value taxation reduces urban sprawl, encourages densification, and promotes inner city redevelopment, it also allows for the use of existing infrastructure and reduces the need to build new infrastructure and extend services, thus lowering the cost of municipal services and infrastructure.

Third, site value taxation is claimed to be a more simple form of property tax that would be less expensive to administer since government no longer has to track improvements. This should reduce data needs and valuation costs. Because assessment would exclude improvements and focus on the market value of land only, some argue that the result is a more objective property tax system — property tax increases created through creative assessments become more difficult (Holle and Owens 2002).

What are the Disadvantages?

Across the literature, the proponents of a tax on the assessed value of land are vocal and committed. As such, it is difficult to find critics. But there are potential downsides. First, under systems of site value taxation, an accurate assessment of the real market value of the land component is critical (Holle and Owens 2002). If accurate assessment does not occur, the theoretical benefits of the tax will be lost. But assessing land value is not always as easy as assessing improvements. Establishing the replacement value of a home, for example, is relatively straightforward.

Second, because site value taxation promotes intensification of land use, some argue it also results in difficulty with preserving open space and parkland within the urban environment. To offset this threat, site value taxation may require both better and more stringent municipal planning and various regulations to preserve open space.

Third, taxing land only may be more simple for government, but it would be less understood by taxpayers. Total property value — land and improvements — is a concept that most property owners understand, and using that as the tax base promotes simplicity at least in the eyes of the taxpayer. Using both is also consistent with finding a broad tax base so that sufficient revenue can be raised with relatively low rates of tax. A broad base and low rates minimize the distortions inherent in every tax. A property tax based on the value of land only will see the broadness of the tax base reduced. This implies higher rates of tax and the potential for wider inequities and more distortions. Taxing both land and improvements is also a more comprehensive measure of wealth (Bell 1999).

Finally, the single biggest question here is how site value taxation could affect development patterns. The literature is not unanimous on this question. Some argue that site value taxation will simply speed up all types of development regardless of location. Others suggest it will speed up development in the urban fringe where land values are lower, particularly in areas with available farmland. Of course, all of this goes against the various proponents of site value taxation, who argue for a clear connection between the tax and a lower incidence of urban sprawl.

Land Value Tax Examples

Site value taxation is not completely unknown in Canada. In the early 1900s, it was common among municipalities in the western provinces. To this day, some municipalities still tax land at a higher rate than improvements. At the same time, the extent of this practice in Canada is not generally known.

Site value taxation and split-rate taxes have been used in numerous cities around the world, including Johannesburg, Sydney, Melbourne, Wellington, as well as cities in Denmark. In Denmark, site value taxation has been working successfully for about 80 years. In the residential sector, the rate of taxation averages 2% of land value with an annual 1% tax on the market value of the home.

While the practice is not widespread in the US, the state of Pennsylvania is a notable exception. Across the state, 15 cities are using, or have used, a form of split-rate taxation. The experience of cities in Pennsylvania provides a tighter link between the theory of split-rate taxation and the actual results that occur on the ground. Split-rate taxation has been credited with limiting urban sprawl, encouraging infill development, and facilitating the revitalization of downtown areas. Split-rate taxation in Pittsburgh dates back to 1913. At one point, the split-rate tax concept was expanded to where land values were taxed at a rate six times the rate applied to improvements. As a result, some say Pittsburgh has a much more compact development pattern than other comparable US cities. In 1974, Pennsylvania's capital city of Harrisburg started taxing land values at a higher rate than buildings. Today, the city taxes land at a rate three times that of improvements. In 1996, residents in Allentown adopted a split-rate tax system. Prior to the change, residential and commercial construction had been in rapid decline. Since 1996, however, the value of new construction has risen considerably. Some have credited the turnaround to municipal tax reform (Hartzok 1997).

As more and more positive evidence begins to emerge, any move toward a straight land tax or a split-rate tax tilted toward taxing land becomes a less dangerous and risky enterprise. However, the change still involves a major shift in municipal tax policy. As such, the best way forward would be gradual implementation with continuous monitoring of the results.

SUMMARY: The property tax is both beaten and bloodied when assessed against some very basic economic considerations. One of the most important relates to equity. For any tax to be considered fair and equitable, it needs to reflect ability to pay considerations or the benefits principle. The property tax does not score well on either. To be fair, some of this results from the way the property tax is administered and applied, and this has led to calls for property tax reform. But this may not be forthcoming any time soon, and no degree of reform will solve other inequities that are inherent to the tax. In many ways, the property tax could be used to facilitate efficiency in the delivery of local government services. But the way it currently works has opened the tax up to the charge that it results in waste, perverse economic incentives, cross-subsidization that redistributes income and benefits, artificial demands for more infrastructure and services, increased consumption, higher total costs, and a loss of accountability. While the property tax is generally seen to be a relatively neutral tax when compared to others, there are some disturbing economic distortions that are cause for concern. Perhaps the most important is how the property tax may be helping to reinforce the drivers of urban sprawl, which works against fiscal sustainability by increasing the costs of providing municipal services and infrastructure.

ADMINISTRATION

> *"Despite its unpopularity, most taxpayers understand how it works even if they do not agree with it. It is easily administered, and is almost impossible to avoid compared to its alternatives."* – *Tim Kelsey (Kelsey 2007)*

> *"It is very difficult to avoid or evade, and collection success rates of 95% are readily achievable."*
> – *UN Food and Agriculture Organization (FAO 2002)*

> *"The result of the Ontario property tax reform is a system that has not changed much in terms of equity but has changed dramatically in terms of the complexity of administration. Attempts to simplify the property tax administration failed. The system for setting rates is so complicated and has changed so many times that some municipalities have been unable to set tax rates correctly."* – *Enid Slack (Slack 2000)*

> *"The system is overgrown with complex and costly assessment rules, asset clauses, tax factors, mill rate rules, rebates, and appeal processes. Moreover, a costly bureaucracy must be maintained at both the local and provincial levels to keep the antiquated machinery operating."*
> – *Saskatchewan Chamber of Commerce (2008)*

1. General Administration

■ *Criteria:* Tax administration speaks to the relative ease and cost of establishing, imposing, and maintaining a tax over time. Taxes that are complex and difficult to administer will see substantial money, time, and effort spent to ensure compliance and collection of the revenue. This makes the tax less attractive. Relative to other tax alternatives and the amount of revenue produced, is the property tax easy and inexpensive to establish, impose, administer, and maintain?

■ *Performance:* The property tax has a long history. This history reflects the fact that it is technically and administratively possible to introduce and impose the property tax in most political and economic circumstances, and to do so with relative ease and low expense compared to other taxes such as income or sales taxes that target annual economic flows. At the same time, every tax can be structured with varying degrees of complexity and this complicates the comparison. It is one thing to set a simple property tax against a highly complex progressive income tax code with its various calculations, deductions, and non-refundable tax credits. It is another thing altogether to compare a highly complex property tax to a relatively simple 10% flat tax on income.

While the property tax is one of the easier taxes to manage, it does entail at least some administrative risk, and these should not be underestimated or dismissed. Most of the trouble here goes back to the lack of objectivity in the tax base, which must be valued according to a process of assessment. Without accurate and reliable assessment, there is the potential for inequities in the tax.

The property tax – like other taxes – requires the development of certain technical expertise and the establishment of a bureaucratic superstructure. While this superstructure is not always visible and it draws far less attention than the Revenue Canada Agency (RCA) or the Internal Revenue Service (IRS), it certainly exists. At the head of this structure are professional assessors that must be highly trained and technically competent. Not only must they have the tools and training to perform assessment, they must have the right tools and training to perform it well. If the property tax system is to operate equitably and fairly, it must be administered in a professional and competent manner. It must also be insulated from negative political influences.

The tasks here are numerous. Assessments need to be conducted accurately and regular reassessments are also required. This requires the creation, maintenance, updating, and monitoring of a property tax roll that tracks developments affecting individual properties. Changes in property ownership, building permits, the sale of properties, and changing market conditions that can have varying impacts across different property types need to be tracked. Detailed studies need to be undertaken to ensure integrity in the assessment process. Irregularities need to be studied and managed, and resources have to be targeted to improving assessment outcomes. Ongoing development and application of new appraisal tools and techniques are needed, and assessors themselves need to be provided with ongoing training unique to the profession.

There is also the matter of deciding and managing various policies and programs for refunds, credits, deferrals and other offsets for those with low incomes. The property tax also requires the establishment and management of valuation tribunals or an assessment review board, as well as a system to facilitate and decide on appeals. Then there are the more mundane tasks of managing the accounting, billing, and collection. All of this needs to be backstopped by IT systems and support staff. All of this costs money and time.

Aside from any administration headache is the political effort required. The property tax does not tend to function as an economically-driven tax but as a politically-driven one. The buoyancy or elasticity of property tax revenue comes about by deliberately and intentionally increasing the property tax rate. This means more than a little political wrangling at budget time. While such debates can ensure a heightened measure of accountability, they can also generate more heat than light. One is left wondering if much of this time could be better spent on matters of more fundamental importance than politicians trying to score points by shaving yet another quarter point off the current year's proposed property tax increase, especially when the so-called "increase" is actually a decrease relative to income growth and inflation.

Research and empirical evidence measuring the cost of property tax administration are scarce. It is generally conceded that the tax is less expensive to administer than many others, and this has worked against an interest in this area. One study suggested that a cost-to-yield ratio of 2% is quite possible (FAO 2002). Another claimed that a well administered property tax might cost $7 for every $1,000 raised (New York Office of Real Property Services 2008).

The costs depend on the complexity of the property tax in use and how many governments have their fingers in it. Since much of the responsibility for the property tax is shared between provincial and municipal governments, it is hard to pin down the real costs of administration. A study that could aggregate all of the costs would likely yield more than a few surprises.

Some have suggested that recent improvements in the property tax have increased the ease of administration. But not all would agree. In some Canadian provinces, there are complaints about the growing complexity and administrative difficulties with the property tax. Some of these difficulties are coming about simply as the tax incrementally develops over time, while others appear to be the result of various reform efforts that have gone sideways (Saskatchewan Chamber of Commerce 2008; Slack 2000).

2. Revenue Collection

- *Criteria:* Although governments are sometimes interested in using taxes to reallocate production in the economy, the collection of revenue is the more important goal. The tax collection rate concerns itself with whether government receives the actual amount of tax that has been levied. What are the collection rates of property tax? Are rates improving? Can rates see slippage?

- *Performance:* Property tax systems have excellent revenue collection rates. In most jurisdictions, 94% to 98% of all current property tax levies are collected on time, with 99% eventually collected as arrears are cleared out (GBPI 2008). In western Canada, property tax collections as a percentage of the current tax levy in Vancouver, Edmonton, Calgary, Saskatoon, Regina, and Winnipeg have averaged well over 95% across the 1990-2007 period *(Discussion Box 6).* While the rate of collection does fall somewhat during times of stress in the broader economy, the changes seen are generally small. Large swings are very rare. The rate of collection has been improving for most of the six cities over time. A high rate of tax collection is perhaps the single biggest advantage of the property tax.

3. Compliance

- *Criteria:* Compliance is the degree to which taxpayers abide by the legal provisions of a tax and submit to government the amount of tax owed. Does the property tax result in relatively high levels of compliance or does it involve a significant enforcement effort?

DISCUSSION BOX 6:
Property Tax Collections in the West

The annual financial reports of the large western Canadian cities show that almost all of the property tax levied finds its way into city coffers on time. Like other jurisdictions, the rate of collection typically exceeds 95%.

Between 1990-2007, the amount of property tax collected as a percentage of the current levy averaged 98.2% in Calgary, 97.9% in Vancouver, 96.3% in Saskatoon, and 96.0% in Edmonton. In Regina, outstanding arrears as a percentage of the current levy averaged only 5.1% across the same time period.

For most of the cities, the rate of collection has also been improving over time. In Vancouver, the rate of collection moved from 97.6% in 1990 to 98.6% in 2007. Similar increases were seen in Calgary (from 97.0% to 99.0%) and Edmonton (from 96.3% to 97.5%). Outstanding arrears as a percentage of the current tax levy have fallen quite steeply in Regina, moving from 7.5% in 1990 to 1.8% in 2007. In Winnipeg, outstanding arrears as a percentage of actual taxes collected were more than halved from 16.3% in 1990 to 7.4% in 2007. Only in Saskatoon has the rate of property tax collection slipped somewhat. In 2007, property tax collections as a percentage of the current levy were 93.9%, the lowest rate seen over the 1990-2007 period.

While collection rates have always remained high, there are two interesting variations here that should be noted. First, property tax data produced by the cities show that the rate of collection can and does fall somewhat during times of broader economic stress. This is indicated by the lower collection rate experienced by most cities during the recession of the early 1990s. Since the late 1990s, collection rates have been on the rise.

Second, while most of these changes are generally small, there are sometimes exceptions to the rule. In 1995, the City of Edmonton collected 96.8% of the current levy. Two years later in 1997, the collection rate fell to 88.9%. The reasons for this are not entirely clear, but such a significant decrease is sure to create at least some disturbance within the municipal operation. These sorts of dramatic swings are very rare. In the end, the high rate of revenue collection represents one of the single strongest benefits of the property tax.

- *Performance:* When it comes to taxation, governments need to guard against two phenomenon – tax avoidance and tax evasion. Avoidance describes the legal efforts of taxpayers to lower their tax liability, while evasion describes the illegal efforts of taxpayers to avoid paying tax altogether. Both speak to the issue of tax compliance, which is generally high when it comes to the property tax. Because of the relative immobility of land and improvements, property taxes are hard to duck – they cannot be easily avoided. Evasion is a virtual impossibility.

High property tax compliance is reflected in the high rates of property tax collection, and it too is a strong advantage of the property tax. Not only does high compliance avoid the costs of punitively enforcing the tax, it carries economic benefits as well. When a tax is hard to avoid, taxpayers will not work up schemes to change their behaviour. In other words, taxes with high compliance are more neutral and this is better for the economy. However, high rates of compliance do not mean the tax is popular. In fact, things might actually work in the opposite direction. Taxpayers are often at least somewhat interested in manipulating the system to lower their tax bill, but there is little room for this when it comes to the property tax. This makes the tax less popular with taxpayers.

4. Enforcement

- *Criteria:* Unlike tax compliance, enforcement speaks to the ability of government to enforce the tax in the event of generally low levels of voluntary compliance or specific cases of individual noncompliance. How easy is the property tax to enforce?

- *Performance:* High rates of collection and compliance mean that enforcement of the property tax is generally a non-issue. When problems do arise, the tax arrears are subjected to a penalty applied on the amount outstanding. This is usually a one-time penalty. A lien can also be set against the property, preventing any transfer until the tax arrears are paid. After a period of time has elapsed, another penalty is usually assessed. From that point on, additional penalties and compounding interest are charged. After a certain number of years have elapsed, properties still in arrears are seized and then auctioned, with the proceeds used to clear the tax bill. Unlike income taxes, the process is quite straightforward. The tax is backed by an asset that can be seized and sold to recoup the taxes owing. With delinquent income taxes, government may have to wait for taxpayers to earn enough additional income to pay the taxes they owe.

SUMMARY: The property tax comes into its own when considering issues of tax administration. Generally, the property tax is viewed as a relatively easy and cost-effective tax to administer and manage. Rates of property tax collection are very high and the immobility of the tax base yields similarly high rates of voluntary compliance. As a result, enforcement issues are typically a non-issue. But the property tax does not win a complete victory here. Equitable application of the tax requires that extreme care be taken in the assessment process. This requires the establishment of a tax superstructure to support the work and information needs of assessment. The tax also requires significant political effort if the revenue produced is to be buoyant over time – growing at a reasonable pace relative to the expenditures it must fund.

THE TAXPAYER

"According to a recent City of Edmonton survey, over 70% of Edmontonians do not understand how their property taxes are administered."
– Rod Risling (City of Edmonton 2008)

"The property tax system is on life support. The rules come in binders that stack several feet high. No one really understands it all."
– Association of Saskatchewan Realtors (2008)

"The language of the real property tax, such as assessments, millage, and common level ratio can be confusing for taxpayers to understand."
– Tim Kelsey (Kelsey 2007)

"Too many governments rely on or manipulate the property tax, making it essentially beyond the normal democratic processes that allow taxpayers to hold the taxing authority accountable."
– Saskatchewan Chamber of Commerce (2008)

"It is very visible and so it's always been the one that got attacked most." – Anne Spray Kinney (Fritze 2008)

1. Simplicity

■ *Criteria:* Taxes that are simple and easy to understand are taxes that are much better for taxpayers. When taxpayers understand how a tax works, they are more likely to accept the tax. On the other hand, taxes that are confusing or difficult will certainly increase the natural suspicion of taxpayers. How simple is the property tax? How easy is the property tax to understand?

■ *Performance:* Conceptually, sales taxes are among the easiest to understand, amounting to little more than a percentage rate applied to a good or service. Even the concept of the income tax is relatively straightforward despite the complexity of the tax code or the tax forms. But the property tax is different. It employs a particular jargon divorced from everyday parlance whether that be permille rates, market value assessment, or fractional assessment factors. Confusion runs throughout the tax. Do taxpayers understand how properties are assessed? Do they understand that business property owners can pay up to four times more tax than residential property owners? Do they understand how property taxes and services are capitalized into property values? Do taxpayers understand that property tax "increases" are often no increase at all relative to rising personal disposable incomes? While the tax requires very little effort on the part of taxpayers to comply, the tax itself is far from simple and is arguably outside the logical frame and mental reach of most. This is one reason why the property tax tends to be unpopular and suffers from low levels of legitimacy.

2. Visibility

■ *Criteria:* Visibility speaks to whether or not taxpayers can easily determine the total amount of tax they pay. High visibility is a positive feature because it allows taxpayers to relate the amount paid to what they earn and also to understand their personal contribution to various public services. How visible is the property tax?

■ *Performance:* The property tax is typically seen as one of the most visible of all taxes. Property taxes are clearly stated on a tax bill that arrives in the mail along with a notice of assessment. As such, most people know to the penny the amount of property tax they pay, even though matters such as assessment remain somewhat of an enigma. All of this is very different from a sales tax embedded in the price of a good or service, which makes it difficult for taxpayers to determine the amount of sales tax they pay in any one year. The situation with income taxes is even worse. While most people at least know the percentage rate of a general sales tax, who really understands their marginal income tax rate? What is more, income tax is typically deducted at source and is never seen. For many taxpayers, income tax time is not a sad time of the year but one of the best times of the year – that is when a different type of envelope arrives in the mail – a windfall in the form of the income tax refund. What many fail to realize is that this refund is actually their own money.

But the property tax is not always a visible tax. First, renters are completely oblivious to the property tax they pay, which is captured through the monthly rental payments. For them, the tax is not visible at all. Even worse, most renters are likely unaware that the effective rate of property tax they do pay is typically higher than that paid by owners of single family homes. Second, many now pay property taxes monthly via automatic withdrawals from their bank account. Because the days of the huge lump sum property tax payment are over, visibility has been blurred somewhat even if it never fully recedes out of view.

The issue of visibility is a double-edged sword. For taxpayers, high visibility allows them to understand their tax burden and this helps promote transparency and accountability in decision-making about the use of tax dollars. This is a clear upside. But visibility also serves to tilt the table in a way that makes it difficult for governments to work with the tax. Intentional increases in the property tax are sometimes inevitable if the tax is to generate a modestly growing stream of revenue. But the high visibility of the tax tends to push against this – taxpayers do not want to hear talk of any increase.

3. Transparency

- *Criteria:* Discussions over transparency proceed down two tracks. First, transparency takes visibility one step further by throwing the basket of expenditures into the discussion. A transparent tax is one where taxpayers not only understand the amount of tax they pay, they also understand what they receive in return. Transparency links the taxes paid to services received. Second, transparency speaks to whether or not there is a good match between those who should pay the tax and those who actually end up paying it. Does the property tax work to establish a clear link between taxes paid and services received? Is there a good sense of who pays and who should be paying?

- *Performance:* Taxes that are highly visible are generally more capable of being transparent. Transparency is also improved when a tax can work on the benefits-based principle. As such, the property tax is inherently a good candidate to serve as a highly transparent tax. However, the degree to which this occurs depends on the availability of information regarding the tax, general knowledge of who pays what, and how the tax is ultimately administered and applied. Conventional wisdom is that the property tax is quite transparent. However, this is not always the case.

The property tax is the only substantive tax at the disposal of Canadian cities. This facilitates a general understanding by taxpayers about the basket of services funded through the tax. The value proposition, however, is somewhat harder to determine. Is the $1,500 paid in annual municipal property tax good value for the services received? Who knows? Much of this is quite intuitive, and intuition is not always accurate.

Transparency is further obscured by the different governmental authorities collecting property tax. Property taxes are not only split between municipal and education purposes, but amounts can also be sent off to regional governments, transit authorities, and various provincial agencies. This complicates the value proposition even further. Taxpayers often make little distinction here, and are more inclined to believe that property taxes are simply too high relative to the municipal services they receive. This happens because only a portion of what they pay actually funds municipal services.

Unequal application of the property tax combined with the fact that varying costs are not always reflected in the amount of tax paid blurs transparency further. Few really understand the degree to which different categories and classes of property pay different effective rates of property tax. While the business community is very aware of their disproportionate tax bill relative to the services they consume, this sentiment is likely not shared across the broader property taxpaying public. In the end, things here are not straightforward. In some ways, the performance of the property tax represents a sad if not tragically lost opportunity.

4. Accountability

- *Criteria:* Accountability in public decision-making is always strengthened when the government doing the spending is the same government doing the taxing. Accountability is maximized when the tax used is simple, visible, and transparent. How well does the property tax score on promoting accountability?

- *Performance:* Because property tax rates are set locally and the revenue raised is used to cover local spending priorities, the tax would appear to foster a certain measure of accountability in local decision-making. The high visibility of the tax also ensures that local governments proceed with a certain measure of caution – each percentage point change in the tax is subject to intense public debate and media scrutiny.

While all of this is a good thing, it alone does not necessarily make the property tax an accountable tax. It is important to remember here that the property tax is an inelastic tax. Also, the tax cannot capture revenue from outsiders who pay their residential property taxes elsewhere but can nonetheless impose a load on many big city services and infrastructure. These two shortcomings of the property tax require that federal and provincial governments transfer grant revenues to local governments. Thus, the property tax also results in a loss of accountability. When it comes to accountability, what the property tax gives with one hand is taken away with the other.

The unintentional and intentional inequities built into the property tax also work against accountability. Again, different effective rates of tax are applied to different categories and classes of property without regard to the cost of services and infrastructure provided to those properties. This results in a system of cross-subsidization, and works against the rationing of spending or at least aligning it with what all taxpayers are willing to pay. It is unaccountable when higher taxes are levied on a relatively small group (e.g., owners of non-residential properties, multi-family properties, and properties near the central core) and the benefits are spread out to a larger group (e.g., owners of residential properties, single-family homes, and suburban properties) who are not charged the full cost. Because the larger group wins a benefit in the form of services and infrastructure received for which they do not pay, the result is increased demands for more services and infrastructure at the expense of those who are already paying higher effective rates of tax. The result is higher total costs of local government, demands for more services and infrastructure, and a lack of certainty about the real needs and real wants of the community relative to what taxpayers are actually willing to pay. All of this is quite unaccountable.

A final concern here speaks to the current democratic dynamic and the property tax. A wide franchise of universal suffrage where all those over 18 can vote also works against accountability. All voters likely pay at least some sales and income tax to federal and provincial governments, but there are plenty who pay no property tax to local governments. This is representation without taxation and it too feeds into the accountability mix. There is a certain amount of potential here for voters who do not pay property tax to support and lobby for more and better municipal services and infrastructure because they do not pay any tax to fund those services. This is not accountability.

5. Legitimacy

- *Criteria:* Legitimacy speaks to the level of public acceptance with a tax and the basic purposes behind that tax. Legitimacy is essential in maintaining compliance and keeping interruptions to a minimum. Legitimacy is largely a function of all the other criteria – especially taxpayer perceptions of equity. A break-down in legitimacy leads to the classic tax revolt. What is the level of legitimacy with the property tax?

- *Performance:* Historically there has been relatively high levels of support for the property tax and at least a certain measure of appreciation for the purposes behind it. But in many ways, this historical appeal seems to be weakening. Increasingly complex administration of the tax is combining with growing inequities that are becoming both more visible and more vocal. The tax itself is not always simple to understand and it is not always transparent. All of this is threatening the level of support for the property tax, even though the tax constitutes a generally small share of the total tax burden. A 2003 survey conducted by the Canadian Federation of Independent Business (CFIB) saw 50% of small businesses rating the local property tax as the single most harmful tax or government charge they face (Nugent 2003). Again, a number of the beefs here relate to the way the tax has developed over time and is currently administered, and opponents to the tax could surely scare up numerous additional reasons. If you are paying attention to local political discourse, it is hard to avoid the conclusion that legitimacy of the property tax is beginning to wane somewhat.

SUMMARY: Conventional perspectives on the property tax assert that the tax is generally simple, visible, and transparent. This translates into a certain amount of potential for the tax to operate in a way that promotes accountability and fosters a certain amount of legitimacy. But things here are not that cut and dry. Relative to other taxes, the property tax is not always simple for taxpayers to understand and intentional and unintentional inequities abound within the tax when viewed from the benefits principle. These combine to lower transparency and work against accountability. The property tax has historically served local governments well, and for the most part, it has been generally accepted by taxpayers. But this legitimacy may be a thing of the past. In certain quarters – particularly within the business community – the tax is losing some of its historical appeal.

WHAT TO DO?

> *"No tax has been more vilified than the property tax. It has been described as unfair because it is unrelated to ability to pay and unrelated to benefits received, unsuitable because it supports services unrelated to property, and inadequate because it does not generate sufficient municipal revenues. Its effects on housing, land use, and urban development have been castigated and its political unpopularity has long been acknowledged by all. Notwithstanding these criticisms, the property tax remains the main source of revenue for municipalities in Canada. It is a valuable source of revenue for local governments and essential to local autonomy."*
> – Enid Slack (Slack 2000)

> *"It is not only impractical and unreasonable to expect cities to fund their increased spending responsibilities and requirements from a single tax, it is almost certain to be economically inefficient and unfair. The time has come for provincial governments to give cities access to additional tax sources."* – Harry Kitchen (Kitchen 2004a)

> *"Certainly, however, there is room to reduce some reliance on property taxes with new taxing powers given to municipalities."*
> – Jack Mintz and Arthur Andersen (Mintz 2001)

1. Property Tax Reform

As a local government revenue source, the property tax does bring a number of advantages to the fiscal table. But like any tax, it also carries along a number of inherent disadvantages. In many ways, these inherent disadvantages have been amplified by current administration of the tax. This state of affairs has resulted in numerous calls for government to reform the property tax. While the suggested reforms run in three separate directions, all of them are designed get the tax working more equitably. In doing so, the hope is that a large number of other problems will be remedied in the process.

■ *End intentional inequities:* Non-residential properties typically pay higher rates of effective property tax than residential properties. Within the residential class, multi-family housing tends to pay higher effective rates than single-family housing. Other potential inequities include the over-assessment of newer properties relative to older properties and a general under-assessment of unimproved land. This discrimination hits not only on the fairness of the property tax but also works against the tax operating as a true benefits-based tax.

It has been suggested that all properties of all classes and categories be assessed in the same way. A single rate of property tax would then be applied against these equalized assessed values. This would ensure that the amount of property tax payable reflected actual property value. This reform would ensure that the tax burden is shared by all property owners according to the relative value of their property, and on that basis alone. This would improve the fairness of the tax, increase efficiency in service delivery and infrastructure provision, and limit economic non-neutralities and tax-induced distortions. The reform would also help the tax score better in terms of simplicity, transparency, accountability, and legitimacy (Kitchen 2004a).

■ *Correct unintentional inequities:* Some of the inequities in the property tax are unintentional and inherent to the tax. An often cited example is how the assessed value of properties "closer-in" are higher than those "further-out" in the suburbs, yet the former are easier and less costly to service while the latter are more expensive. This produces a cross-subsidization effect that increases the demands for more services and infrastructure and may also be feeding urban sprawl. It has been suggested that additional rates of property tax – whether it is called a surtax, variable rate, special assessment charge, area rate, or graduated tax – be applied to properties in locations that are more expensive to service. This would draw a tighter link between taxes paid and the cost of services and infrastructure consumed, and would result in better equity and economic efficiency. While determining the additional amount of tax based on the additional cost may be somewhat difficult, at least one city in Canada has managed to head down this road. The City of Halifax has three basic tax rates for urban, suburban and rural, plus a set of 60 additional benefitting area charges (Kitchen 2004a).

■ *Examine split-rate property taxation:* Most Canadian cities tax both land and improvements equally as one package. This may not be the most efficient form of property tax, particularly given current equity concerns and current growth patterns leading to urban sprawl and the higher costs that come with it. Several US experiments with a split-rate property tax indicate a range of potential benefits that might flow from this reform. Governments should be examining this option more closely and help facilitate the necessary research and development of specific case studies to uncover whether or not this option should be considered. However, any move in this direction needs to be examined closely first, and then gradually implemented.

For most advocates of property tax reform, it is the wide range of inequities in the property tax that create most of the problems. If these inequities could be sorted out and corrected, local governments could make better use of the property tax. Not only could the property tax be made to work more effectively and efficiently, legitimacy and public acceptance of the tax would improve as well. However, these reforms also swim against the current of the political dynamic that exists on the ground. No government financing system is entirely equitable and neutral. In other words, there are groups of winners and losers that surround the fiscal status quo. Those who draw a net benefit will fiercely oppose any change that could lower their benefit. This has always been the Achilles heel of any tax reform effort, and is also why tax reform is one of the most difficult policy plays for any government to pursue.

One example should suffice. In most large modern cities, the great bulk of the voters live in single-family homes located in the suburbs. These neighbourhoods are arguably more expensive to service and also require massive amounts of infrastructure to connect them into the civic network. Any proposal to equalize the property tax will certainly see the taxes paid by these voters increase at the same time as over-taxation elsewhere is ended. The proposal will be highly unpopular and will likely end up “dead on arrival” at the steps of city hall.

Fundamental property tax reform is both a worthwhile and laudable pursuit – the benefits would be many. Whether such reform is politically achievable is another matter altogether. But reform has another problem. Even with a fundamentally reformed property tax in hand, local governments would remain completely dependent on this one single tax source and all of its inherent disadvantages. This has prompted calls for a different approach – diversifying the local tax mix.

2. Diversifying the Local Tax Mix

The best possible tax would provide adequate, reliable, and predictable flows of revenue and would be relatively responsive to economic and population growth. The best possible tax would be easy and cost effective to establish and administer, and would see high rates of voluntary compliance. The best possible tax would be equitable and economically efficient, and would also be perceived as such. The best possible tax would be simple to understand, visible, transparent, and allow taxpayers to hold government accountable with how the revenue is spent. There is just one problem – *such a tax does not exist.* All of the criteria discussed above involve a number of trade-offs that simply cannot be managed within a single tax source. For example, a tax that produces reliable flows of revenue cannot at the same time be highly responsive to economic growth. Either the tax is relatively inelastic and produces consistent revenues, or the tax is highly elastic and runs the risk of variable revenue flows due to changing economic conditions.

All of this underscores a very basic point – *it is the lack of diversity in the local tax regime that is the key issue.* The matter cannot be reduced to simply selecting a “better” tax than the “lousy” property tax. Rather, the challenge is to create a more diverse basket of tax tools and tax revenue-sharing options that might work better. Only with a diverse set of tax tools can all of the positive aspects of the criteria above be put into play. In other words, it is important to recognize the benefits that accrue from a diversity of tax tools and revenue levers. The property tax and the fiscal challenges confronting western Canada’s cities constitute a powerful argument for employing a range of tax tools and revenue levers, where the disadvantages of one tax – the property tax – can be offset by other taxes. A diverse tax system with the property tax as one component of many allows all the advantages of that tax to be retained, while the disadvantages are offset by the presence of other taxes.

For example, sales taxes, particularly when applied to a broad base, are much better tools for capturing revenue from outsiders and commuters coming into the city. Income taxes are much better tools for financing local expenditures like social, community, and family services that have a strong income redistributional component. In many ways, these taxes provide a good fit for the circumstances of large cities, but they are not currently open to use by local governments. This stands in stark contrast to most of western Canada’s competitor cities, whether in the US, western Europe, or southeast Asia.

With the growing importance of cities in the new global economy, the singular reliance of Canada’s cities on one distinct tax source constitutes a competitive disadvantage. While this conclusion requires more detailed analysis than can be provided here, the analysis above points in this direction. The fact is, diversity in taxation yields a number of important benefits. A singular and relatively heavy reliance on one tax may worsen inherent economic distortions because they are not counteracted by other types of taxes. Aside from providing balance, diversity also allows for more flexibility. But all this is just the tip of a much larger policy iceberg. The larger rationale for tax diversity rests on a complex argument that weaves together a variety of demographic and fiscal considerations with concerns over governance, economic impact, and various political factors as well *(Discussion Box 7).* But what types of taxes should be considered? How could new taxing authority be implemented?

Any move to provide new forms of municipal taxation should focus attention first on a range of selective sales taxes that target vehicle usage and visitors. These taxes are not necessarily paid by all residents equally, but are indirectly related to the services and infrastructure consumed. User or benefit taxes are some of the most efficient and equitable taxes available, essentially acting as a proxy for the more direct user fee. For example, the amount of fuel tax paid by an individual is directly related to how much driving that individual does, and indirectly, to how much municipal infrastructure is consumed during the course of that driving. Other examples here might include selective sales taxes on vehicle registrations, accommodations, entertainment, restaurants, and car rentals. All of these taxes are an obvious first choice.

Second, a broad based local sales tax with very low rates of tax would be highly beneficial. The tax could be implemented across the larger city-region and piggy-backed onto the provincial HST or the federal GST. This tax would allow for more fiscal equivalence across large cities and ensure that regular visitors to the city contribute to the local tax base. The broad base, the low rate, and wide application would offer significant revenue potential without the threat of producing large distortions.

A third option is a small income tax to help cities fund their growing social and income redistributional expenditures. However, income taxes can produce economic distortions simply because of the ease with which they can be avoided or exported. While locally-levied taxes do the best job in promoting accountability, a second best option is to have provincial governments share a portion of their personal and corporate income tax revenue with cities. This reflects the process currently in place in Manitoba, where the province shares 2.2% of all personal income tax and 1% of all corporate income tax with municipalities through a per capita grant.

Diversifying the local government tax structure may be just as daunting as pursuing fundamental property tax reform. Thus, it does require some strategic thinking in terms of how to move forward. There are three broad approaches open. First, cities can simply be provided the authority to levy a range of new taxes. This approach is easy to frame and understand. The downside is that it could imply an increase in taxation. Given that property tax revenues have fallen relative to GDP and personal disposable incomes, this may be less problematic than it first appears, but it can hardly be considered the most attractive option.

Second, the federal and provincial governments could transfer some tax room to cities, avoiding an increase in overall taxation. This approach recognizes the problems with the municipal tax structure, but also recognizes that a higher effective tax burden in the current economic circumstance may not be the appropriate response. However, movement here is limited. Federal and provincial budgets are already stressed and teetering on the verge of deficit. In the end, the competition for scarce tax dollars is fierce.

A third approach would see cities sidestepping objections over a tax increase and pressuring the budgets of other governments by sacrificing property tax revenue now as an investment toward better tax tools in the future. Cities could commit to a significant one-time reduction in the property taxes they collect. That could stimulate the start of negotiations to secure some new taxing authority. To ensure a win-win-win for taxpayers, the province, and the cities, the tax swap should be revenue neutral in the short-term. Even more traction would occur if the tax swap were to act as a short-term tax cut – if the new tax revenues did not make up the entire difference in foregone property tax revenue. This short-term revenue loss in the operating budget could be absorbed by reducing the amount of pay-as-you-go dollars transferred to capital. Because many Canadian cities currently have relatively low amounts of tax supported debt, some modest borrowing in the short-term could be taken on to support infrastructure until the revenue generated by the new tax tools closes the gap. With this approach, cities would be offering taxpayers, as well as the province, the potential for a reduced tax load. Such a scenario ultimately results in a win for everybody. Although the approach does not address the short-term and immediate fiscal needs of the cities, it does offer the prospect of a much more sustainable fiscal future. In the end, no policy choice is ever free – all come with at least some cost.

DISCUSSION BOX 7: Rationale Behind a New Tax Mix

In *Rationale for Renewal: The Imperatives Behind a New Big City-Provincial Partnership,* the Canada West Foundation laid out the reasoning for a more diverse tax regime for large cities. The rationale rests on a complex argument that weaves together a variety of fiscal and demographic considerations with concerns over governance and certain economic and political factors.

- *The Fiscal Rationale:* A more diverse tax system would result in better revenue growth — not by intentionally increasing property tax rates year-over-year — but by using taxes that link to economic growth. An expanded set of tax tools yields better growth in revenues by allowing cities to draw a continual portion of the economic growth occurring in the local region. For example, revenue from sales and income taxes grow based on the inherent vitality of a broad tax base that naturally expands over time.

- *The Demographic Rationale:* Lowering the dependence on property taxes and using a more diverse set of taxes would enable cities to better cope with the rapid pace of urbanization, compensate for current patterns of population growth, and deal with urban sprawl. Rapid population growth increases the demand for more services and infrastructure systems, but property tax revenue does not always keep pace. More elastic taxes would allow cities to better accommodate growth through tax revenues generated by that growth. Tax diversity is also critical in accommodating peripheral growth that does not always translate into additional property tax revenue. In the absence of sufficient federal and provincial grants that can serve as a fiscal offset, there are only two options remaining. First, a city-region can be amalgamated. But amalgamation involves a loss of local control, it can bid up the costs of municipal services, and it also stifles the impulse for creativity and competition between various municipalities in a city-region. A second, and much more creative option, is to allow cities a more diverse tax system that enables them to equalize these fiscal pressures themselves. Finally, the property tax may encourage sprawl (Slack 2002). Lowering the property tax and replacing the lost revenue with other taxes may help limit sprawl.

- *The Governance Rationale:* Just as cities have grown in size, importance, and complexity, so have the issues with which they must contend. Many of these new responsibilities are directed toward "people" as opposed to "property." Social issues unrelated to property services are better handled by other forms of taxation with a broader tax base, such as the personal or corporate income tax. Increased tax diversity at the local level provides an opportunity to better match revenue-raising capacity with current municipal expenditures — squaring current responsibilities with appropriate financial resources. Given the interconnectedness of governments today, disentanglement is likely not an option. Neither can cities simply withdraw from these areas of responsibility. However, tax diversity at the local level remains a viable alternative.

- *The Economic Rationale:* In the new globalized information economy, new systems of taxation need to be considered if cities are to fund a high quality package of infrastructure and services that can attract and retain the highly skilled labour necessary for local, provincial, regional, and national economic success. At the heart of the matter is how Canada's municipal tax distinctiveness may constitute a competitive disadvantage for our cities. It is important to recognize the benefits that accrue from a diversity of tax tools and revenue levers. No single tax is entirely fair or neutral with regard to investment patterns, economic distortions, or decisions about location and business inputs. Nor is every tax equally suited to generating predictable, stable and growing streams of revenue. No single tax source is equally suited to compensating for inflation, capturing growth in the local economy, or controlling for the problems with free-riding and fiscal disequivalence that inevitably result from more and more people filling the beltways around our cities. Singular reliance on the property tax and the fiscal challenges facing our cities constitute a powerful argument for employing a range of local tax tools and revenue levers, where the advantages of the property tax can be retained at the same time that its disadvantages are offset by the presence of other taxes. It is simply unreasonable to expect one tax alone to carry the burden of funding today's large cities (Kitchen 2002).

- *The Political Rationale:* A more diverse tax system provides the opportunity to establish better accountability. Only locally raised taxes and locally decided government expenditures can ensure the highest level of accountability. Singular reliance on the property tax means grants will remain an important feature on the local fiscal scene, despite the accountability issues they create. In addition, there is a potential for a new political coalition to drive the push for change. Typically, lower and modest income individuals reside in multi-family housing that is effectively over-taxed. Business leaders are also over-taxed. Environmentalists should be concerned with the efficient provision of infrastructure and services and curbing sprawl. Senior citizens on fixed incomes should be concerned about the property tax and its weak link to ability to pay considerations. All of these groups have sometimes possessed conflicting goals, but their interests do converge when it comes to the drive for a more diverse local tax system.

In addition, provincial governments and the cities would be well-advised to make new taxes dependent on voter approval, have a ceiling in place which caps the tax rates, and where appropriate, even earmark the revenues for specific purposes such as infrastructure investment. Subjecting new taxes to a sunset clause and issuing regular public reports on how the tax revenue has been used are advantageous as well. All of these will increase accountability, ensure a measure of democratic participation, and increase the likelihood of voter approval and taxpayer acceptance of any new taxing measures.

The overall strategy, then, is to keep the property tax as a foundational tax but make available a set of other taxes that can act as an important supplement. In this way, all of the advantages of the property tax are retained at the same time that an offset is provided for the disadvantages. This is precisely how most other cities around the world are financed.

CONCLUSION

> *"Like most municipalities these days, Edmonton's rapidly escalating expenses cannot be expected to be matched by similar increases in grants and supplementary revenue sources. In the long-run, Edmonton must obtain a more flexible and progressive tax source than property – one which more suitably represents a sharing of revenues being generated within local and provincial economies..."*
> *City of Edmonton (Annual Financial Report 1974)*

> *"As a former mayor, it would be hypocritical of me to say that municipalities ought not to have the ability to raise revenues or more options because I made that case when I was mayor. I made that case to a special legislative committee. As a matter of fact, I was the mayor who proposed the hotel room tax. The province thought it was such a good idea that they took it."*
> *– Ralph Klein (in the National Post, March 13, 2002)*

Historically, the property tax may have served our cities well. The tax has a number of distinct and inherent advantages that make it attractive as a local tax source. But these advantages do not stand alone. They also have a flip-side in the form of corresponding disadvantages that are becoming more problematic. The financial challenges facing the West's big cities coupled with concerns over the property tax and questions about long-term fiscal sustainability are a powerful argument for changing the way cities do business. Reforming the property tax, reducing dependence on it, and diversifying the local tax mix are all part of this larger goal.

Fixing the tax side of the municipal fiscal ledger is part of the solution. But it alone is not the solution. Property tax reform and more diverse revenue sources should be seen as part of a much larger package of alternatives that also includes focusing on core responsibilities and priorities, expanding user pay wherever possible, pursuing better pricing models, exploring new modes of program and service delivery, and adopting more creative and innovative infrastructure financing and funding.

But taxes are important. And it is not just the level of taxation but the types of taxes being used. Other cities around the world serve as the benchmark. Many of those cities have a longer history, have been better able to assert themselves, and also rely on a more diverse tax base of which property is only one. Canadian cities need to catch-up. A broad consensus is emerging regarding the specifics of the property tax and the wider financial challenges facing Canada's cities and how to best resolve those challenges. Convergence is evidenced by commentary and research coming not only from the policy community but also the private sector, various provincial and national municipal associations, and the media. The public also senses a need for change here – even though it is more difficult to gauge their views on appropriate responses.

What if nothing changes? There are two identifiable schools of thought. The first school suggests that if a new direction is not found, cities will simply continue limping along with the property tax and going cap in hand to the other orders of government. Cities have historically been successful with this approach and will likely manage to adapt and muddle through – the urban boat will keep afloat and the world will go on. At the same time, this is hardly an inspiring vision for the future, and it does nothing to help build world-class cities.

The other school of thought is more alarming. If healthy cities are indeed a prerequisite to raising standards of living, bettering socio-economic equality, and providing a high quality of life, then the status quo can be seen as seriously threatening Canada's future economic and social progress. The status quo means cities are at the beginning of a downgrade. Features of this downgrade include decreased and deteriorating quality of local services to residents, widening of the infrastructure funding challenge, increased poverty and socio-economic inequalities, and a general reduction in the quality of life and attractiveness of our cities. The property tax alone is not up to the job. It is time to cast our urban eyes further afield and look at some new options. ■

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About the Canada West Foundation

Our Vision
A dynamic and prosperous West in a strong Canada.

Our Mission
A leading source of strategic insight, conducting and communicating non-partisan economic and public policy research of importance to the four western provinces and all Canadians.

Canada West Foundation is a registered Canadian charitable organization incorporated under federal charter (#11882 8698 RR 0001).

In 1970, the One Prairie Province Conference was held in Lethbridge, Alberta. Sponsored by the University of Lethbridge and the Lethbridge Herald, the conference received considerable attention from concerned citizens and community leaders. The consensus at the time was that research on the West (including BC and the Canadian North) should be expanded by a new organization. To fill this need, the Canada West Foundation was created under letters patent on December 31, 1970. Since that time, the Canada West Foundation has established itself as one of Canada's premier research institutes. Non-partisan, accessible research and active citizen engagement are hallmarks of the Foundation's past, present and future endeavours. These efforts are rooted in the belief that a strong West makes for a strong Canada.

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