
Property Tax Reform in Ontario: What Have We Learned?

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ABSTRACT

The introduction of market value assessment in Ontario in 1998, accompanied by the reform of property tax policy, has had a major impact on municipalities across the province. This paper describes and evaluates the recent reform of property taxes in Ontario. It argues that the goal of ensuring stability of property taxes has been achieved at the expense of equity and simplicity. The reform may have reduced inequities within the residential property class, but it has maintained inequities within the non-residential property classes. More generally, the lesson from the Ontario experience is that, no matter how desirable the long-run outcome of a policy change, the transitional effects may be sufficiently undesirable to require measures to cushion the impact of the reform. This problem is not unique to property taxes, but it is particularly significant in this case because of the visibility of the tax.

KEYWORDS: PROPERTY TAXES ■ TAX REFORM ■ ONTARIO ■ MARKET VALUE ■ MUNICIPALITIES ■ EQUITY

INTRODUCTION

No tax has been more strongly criticized than the property tax. It has been described as unfair because it is unrelated to ability to pay or to benefits received, unsuitable because it supports services that are not related to property, and inadequate because it does not generate sufficient revenues for municipalities to meet their rising expenditure needs. Its effects on housing investment, land use, and urban development have been castigated, and its political unpopularity has long been acknowledged. Notwithstanding these criticisms, the property tax remains the main source of revenue for municipalities in Canada.¹ Not only is it a valuable mechanism for funding local governments, but it is also essential in sustaining local autonomy. The formulation of property tax policy, at both the provincial and the local levels, thus has important consequences for the overall workings of municipal government.

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This paper describes and evaluates the recent property tax reform in Ontario. The first section of the paper describes the unique characteristics of the property tax that make reform particularly challenging. The second section provides a brief history of property tax reform in Ontario. The third section describes the recent property tax changes in Ontario. The fourth section evaluates the property tax reform and sets out some lessons for tax policy.

CHARACTERISTICS OF THE PROPERTY TAX

There are several characteristics of the property tax that differentiate it from other taxes and also make it difficult to reform.

First, the property tax is a very visible tax. Unlike the income tax, for example, the property tax is not withheld from taxpayers' earnings at source. Generally, it must be paid directly by taxpayers in periodic lump-sum amounts. Consequently, taxpayers tend to be much more aware of how much they pay in property taxes.² Furthermore, the property tax finances services that are very visible, such as roads, garbage collection, snow removal, and neighbourhood parks. This visibility is desirable from a decision-making perspective because it makes taxpayers aware of the costs of local public services. This awareness enhances the accountability of local governments for their expenditure decisions. The ability to raise property taxes (or to reform the tax), however, is more constrained than is the case for other taxes.

Second, the base of the property tax does not increase automatically over time because property values respond more slowly to annual changes in economic activity than do incomes. Furthermore, few jurisdictions update property values for taxation purposes on an annual basis. This means that, to maintain property tax revenues in real terms (or to increase those revenues), it is necessary to increase the rate of the tax. As with visibility, inelasticity leads to greater accountability because when taxing authorities need to increase tax revenues, they have to justify the increase in the tax rate. However, inelasticity also leads to greater taxpayer resistance.

Third, in most North American jurisdictions, it is common for the property tax to favour single-family residential owner-occupied properties over apartments and commercial and industrial properties. Favourable treatment of single-family residential properties is achieved in three ways:

1. The assessment system deliberately underassesses single-family residential properties as compared with apartments and commercial and industrial properties of comparable value.
2. Many jurisdictions have legislated lower tax rates on single-family residential property.
3. Property tax relief measures are often provided to residential property owners (and, in some cases, tenants) in the form of tax credits, homeowner grants, or tax deferrals. These measures are not generally available to non-residential properties.

At the same time, this differential treatment does not necessarily reflect the differential use of services by different property types.³

Fourth, some have argued that property taxes are regressive. This means that the burden of the tax is relatively heavier for low-income households than for high-income households. Whether or not property taxes are regressive, this perception has led governments to introduce a number of different tax relief schemes for residential properties.⁴ Nevertheless, increases in the property tax are often met with resistance on the grounds that low-income households cannot afford to pay the tax.

HISTORY OF PROPERTY TAX REFORM IN ONTARIO

The modern history of property tax reform in Ontario began with the report of the Ontario Committee on Taxation (the Smith committee) in 1967.⁵ This committee, like similar committees in other provinces at that time, condemned the property tax for being regressive and for being inequitably administered (because properties of similar value were not assessed the same amount). The report recommended, among other things, that real property be assessed at “actual” value and that the province play an increased role in assessing real property. At that time, property assessment was a local function.

The province took over the assessment function from municipalities in 1970 and made a commitment to adopt full market value assessment as the base for property taxes throughout the province. The proposed market value assessment was one of the most important tax changes considered in Ontario because it implied tax shifts from some sections of the community to others. Since those on the losing side are most likely to be unhappy, it may be expected that any government that proposes to carry out such a policy change is not going to find it easy and will likely have to compromise and negotiate with the affected groups. Ontario’s experience over the subsequent 30 years certainly shows this to be true.

Following several postponements of the scheduled date for the introduction of province-wide market value assessment, the 1976 provincial budget set out a series of reforms to the tax system that were needed before market value assessment could be introduced. In other words, assessment reform could not be implemented without tax policy reform. The proposed reforms included taxing residences on 50 percent of market value and other properties on 100 percent, a uniform business tax, limits to exemptions, phase-ins, and other tax changes.

After the release of the budget, the provincial government appointed the Commission on the Reform of Property Taxation in Ontario (the Blair commission) to consider the property tax proposals in more detail. The Blair commission reported in 1977⁶ and supported the main recommendations of the 1976 budget. The government’s response to the Blair commission was to issue yet another set of proposals in 1978 known as “the alternative system.” This document supported the budget proposals but removed the idea of a uniform business tax. It made some other changes as well.

Yet another committee—the Provincial-Local Government Committee—was established in 1978 to consider the same proposals. The committee's report⁷ supported many aspects of the alternative system, with two major changes. First, residential properties were to be taxed on 50 percent of market value, but now multiple residences were to be taxed on 75 percent of market value. Second, Metro Toronto was to be allowed to deviate for up to three years from the general 50 and 75 percent rates proposed for residential and multiresidential properties—for example, by setting rates at 45 and 80 percent, respectively. This change was designed to cushion the impact on Metro Toronto, where apartments were even more overassessed than in other municipalities. In short, the effect of these tax policy recommendations was to reduce substantially the tax shift that would have occurred from full market value assessment, especially for owners of single-family residences.

Notwithstanding all of the efforts to cushion the impact of market value assessment, the treasurer announced in 1978 that property tax reform would not be implemented. In November 1978, the minister of revenue confirmed that none of the changes proposed earlier would be legislated but that municipalities could, at their option, apply to the province under then section 86 of the Assessment Act for reassessment within classes of property (single-family homes, apartments, commercial properties, etc.). Many municipalities across the province exercised this option; Metro Toronto did not.

A new Liberal government in 1985 once again took up the challenge of property tax reform. It commissioned a further study of assessment and property taxation. The resulting report (appropriately titled *Taxing Matters: An Assessment of the Practice of Property Taxation in Ontario*)⁸ also recommended market value assessment, but yet again, the government backed away from implementation.

In 1993, the New Democratic Party (NDP) government commissioned another study to review property taxation (as well as other forms of taxation) in Ontario. The Ontario Fair Tax Commission made several recommendations on property taxation and municipal and education funding.⁹ Unlike any other study of property tax reform, however, it recommended unit value assessment—a relatively new concept in Ontario. Unit value assessment focuses on the size of the property and not on variables such as location.¹⁰ This recommendation was not implemented either.

The NDP government established the Greater Toronto Area (GTA) Task Force in 1996. Problems with the property tax in Toronto had become urgent by this time: assessment appeals were eroding Metro Toronto's tax base, and there was a feeling that businesses were leaving Metro because of high property taxes. To the extent that appeals are successful, the assessment base is eroded, and all taxpayers then face higher tax rates. These inequities have also created what has been referred to by the Toronto Board of Trade as “the hole in the doughnut”; higher taxes on businesses in Toronto relative to the rest of the GTA provided an incentive for businesses to leave Toronto. Among its recommendations, the GTA task force recommended actual value assessment.¹¹ The task force completed its work under the new Conservative government.

In response to the task force report, the government established the Who Does What Panel to address issues in property taxation as well as the realignment of provincial and local responsibilities. The panel recommended the implementation of a uniform value-based assessment system province-wide (current value assessment) with variable tax rates.¹² The provincial government implemented the new assessment system in 1998. The tax policy reform that followed, however, was probably more complicated than anyone had ever imagined.

RECENT REFORM OF PROPERTY TAXES IN ONTARIO

Starting in January 1998, a uniform assessment system based on “current value” (similar to market value) was implemented province-wide. Every property was assessed as of the same valuation date, June 30, 1996. The next reassessment has been done for 2001; after 2005, annual updates will be done using a three-year rolling average.

The change to a uniform province-wide assessment system by itself would have resulted in large shifts in tax burdens within and between classes of property. For this reason, tax policy changes were introduced along with assessment reform. Indeed, the provincial government introduced seven pieces of legislation in all.

Before the reform, municipalities were required by legislation to levy differential tax rates on residential and non-residential property. Specifically, the residential rate had to be 85 percent of the non-residential rate. Following the assessment reform, municipalities are allowed to levy variable tax rates for different classes of property:

- residential,
- multiresidential,
- commercial,
- industrial,
- pipelines,
- farms, and
- managed forests.

Subclasses to which rate reductions apply are vacant commercial (35 percent reduction), vacant industrial (30 percent reduction), farmland pending development, and certain theatres in the city of Toronto. Furthermore, the commercial class can be divided into three subclasses according to value, with graduated tax rates applied to each subclass. The tax rate on farms and managed forests is legislated to be 25 percent of the residential tax rate.

As well, optional classes that municipalities can choose include

- new multiresidential,
- shopping centres,
- office towers,

- parking lots and vacant land,
- professional sports facilities, and
- large industrial.

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

Ranges of fairness were set by the provincial government as shown in table 1.

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

Variable tax rates within ranges of fairness were used to allow municipalities to maintain the existing tax burdens between classes and reduce the impact of a reassessment. These provisions raise the question whether these discrepancies between classes of property should be allowed to remain. Two arguments can be made. On the one hand, provincial ranges of fairness could be considered to be inappropriate because the property tax is a local tax. Since municipal politicians are accountable to the electorate, they should be responsible for setting tax rates without provincial restrictions. On the other hand, municipalities are unlikely to eliminate the discrepancies on their own (especially if it means shifting tax burdens onto residential properties), and thus some form of provincial regulation is required to achieve fairness. The compromise (recommended by the Who Does What Panel and implemented by the provincial government) was to establish provincial ranges of fairness and require only that municipalities not move further away from them.

In addition to variable tax rates, the province legislated phase-in provisions and tax deferrals to address the shifts that would occur within classes of property, especially within the residential property class. Municipalities, at their option, can apply a phase-in for up to eight years for assessment-related tax changes. Interclass subsidization is not permitted; for example, tax decreases in the commercial class cannot be used to subsidize tax increases in the residential class. Different schemes can apply to different classes; different phase-in periods can be used for decreases and increases. Municipalities are required to establish a program to mitigate assessment-related tax increases for residential properties owned by low-income seniors and the disabled. They can design their own mitigation programs.

The timing of phase-ins is also controversial because of the conflict between moving to a fairer system as quickly as possible and lessening the impact on those whose taxes will increase. One could argue, on the one hand, that the existing

TABLE 1 Provincial Ranges of Fairness

Property class	Allowable range of fairness
Multiresidential	1.0-1.1
New multiresidential	1.0-1.1
Commercial	0.6-1.1
Office building	0.6-1.1
Shopping centre	0.6-1.1
Parking lots and vacant land	0.6-1.1
Professional sports facility	0.001-1.1
Industrial	0.6-1.1
Large industrial	0.6-1.1
Pipelines	0.6-0.7

inequities should not be allowed to continue; on the other hand, it may not be wise to create undue hardship by not phasing in the tax changes.

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

The result of capping was to freeze the assessment roll based on 1997. In other words, the new assessment roll was not used to tax multiresidential, commercial, or industrial properties from 1998 to 2000. Capping also meant that there was no effort to remove or even reduce the inequities in property tax burdens within the commercial, industrial, and multiresidential property classes. Instead of capping of the amount of the tax increase arising from a reassessment, the tax itself was capped.

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

For 2001 and subsequent years, municipalities are required to limit the assessment-related property tax increases on commercial, industrial, and multiresidential properties to 5 percent per year. Municipal levy increases (that is, year-over-year municipal tax increases) are not permitted in a property class if a municipality's tax ratio for that class exceeds the prescribed threshold ratio. The following threshold ratios (where thresholds represent provincial averages) have been prescribed: commercial, 1.98; industrial, 2.63; and multiresidential, 2.74. Essentially, this means that, for those municipalities over the threshold levels for all three property classes, any tax increase resulting from budgetary increases has to be borne by residential property taxpayers. A frozen assessment listing is no longer required for the administration of the new 5 percent limit.

EVALUATION OF THE RECENT REFORM

The result of the Ontario property tax reform is a tax system that has not changed much in terms of equity but has changed dramatically in terms of the complexity of administration. Current value assessment is being used for residential properties. This means that residential taxpayers have finally moved to a market value system—in some cases, with a phase-in. The assessment on multiresidential, commercial, and industrial properties, however, has virtually been frozen at pre-reform levels.

A uniform assessment system with variable tax rates provides much more visibility and accountability than the previous system, in which property tax differentials were hidden in the assessment method. Wherever anyone locates in the province, similarly valued residential properties are assessed at a similar value. Tax rates differ by location depending on the level of service and local government decisions about relative tax burdens.

In terms of neutrality, differential property taxes will be distortionary unless they reflect different benefits received. It can be argued, for example, that the benefits from local public services are different for different property classes. In particular, a case can be made on benefit grounds for taxing non-residential properties at a lower rate than residential properties. However, it appears that, under the Ontario property tax reform, differential property tax rates reflect the desire to maintain relative tax burdens and not to achieve fairness based on benefits received from municipal services.

Because of the focus on tax stability for each tax class, the initial goal of the reform—to achieve equity based on ability to pay—was lost completely. The inequities between classes of property have not been eliminated, and the inequities within classes (other than the residential class) have not been reduced.

The reform has meant that the assessment function has been downloaded to a corporation comprising mostly municipal officials; the tax-setting process is, to a large extent, controlled by the provincial government. Although municipalities have control over the level of taxes, their control over the distribution of taxes among classes of property has been severely constrained by the province.

Attempts to simplify property tax administration have failed. The system for setting tax rates is so complicated and has changed so many times that some

municipalities have been unable to set tax rates correctly. As a result of the capping legislation, property tax bills that were issued in 1998 had to be reissued in some cases in 1999.

Important lessons can be learned from the reform of property taxation in Ontario. The longer you wait to reform a tax, the more difficult it will be. Annual reassessments for property tax purposes will create far fewer shifts in taxes than a reassessment after 40 years.

The ability to reform the property tax is more constrained than is the case for other taxes because of the visibility of the tax. It is particularly difficult to shift tax burdens onto residential property. Favouritism toward residential property is an inherent part of the property tax system. Trying to change the way this tax is levied is politically difficult. At the very least, phase-ins and tax deferrals are an essential part of the tax policy design.

Taxpayers need to have confidence in the assessed values and the process used to derive them. This means taking the time to do the assessment properly. Furthermore, before property tax reform is implemented, it is necessary to undertake an impact assessment to determine the shifts in taxation. This needs to be done in advance so that tax policy can be designed before the reform comes into effect, and not in a piecemeal fashion in response to problems as they occur.

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

NOTES

- 1 As Harry Kitchen notes in his paper at this symposium, in 2000 property taxes accounted for more than 53 percent of municipal revenues in Canada. See Harry Kitchen, "Canadian Municipalities: Fiscal Trends and Sustainability" (2002) vol. 50, no. 1 *Canadian Tax Journal* 156-80.
- 2 In some cases, however, mortgage institutions include property tax payments with monthly mortgage payments. This procedure reduces the visibility of the property tax for taxpayers to whom these arrangements apply.
- 3 It has been suggested that non-residential properties use fewer services than residential properties but pay more in taxes. Users of non-residential property often provide their own garbage collection, security, and fire protection. For example, see Harry Kitchen and Enid Slack, *Business Property Taxation*, Government and Competitiveness Project Discussion Paper no. 93-24 (Kingston, ON: Queen's University, School of Policy Studies, 1993), 23.
- 4 For a discussion of the incidence of the property tax and property tax relief schemes, see Richard Bird and Enid Slack, *Urban Public Finance in Canada*, 2d ed. (Toronto: Wiley, 1993), 88.
- 5 Ontario Committee on Taxation, *Report* (Toronto: Queen's Printer, 1967).
- 6 Ontario, *Report of the Commission on the Reform of Property Taxation in Ontario* (Toronto: Government of Ontario, 1977).

- 7 Ontario, *Report of the Provincial-Local Government Committee on Property Tax Reform* (Toronto: Government of Ontario, April 1978).
- 8 Ontario, *Taxing Matters: An Assessment of the Practice of Property Taxation in Ontario* (Toronto: Ministry of Revenue, 1985).
- 9 Ontario, *Fair Taxation in a Changing World: Report of the Ontario Fair Tax Commission* (Toronto: University of Toronto Press in cooperation with the Ontario Fair Tax Commission, 1993).
- 10 For a discussion of unit value assessment, see Enid Slack, "Property Taxation," in Mila Friere and Richard Stren, eds., *The Challenge of Urban Government: Policies and Practices* (Washington, DC: World Bank Institute, 2001), 269-79, at 272.
- 11 Greater Toronto Area Task Force, *Greater Toronto: Report of the GTA Task Force* (Toronto: Queen's Printer, January 1996).
- 12 Ontario, Who Does What Panel on Local Governance, *Recommendations* (Toronto: Who Does What Panel, 1996).