TO:	**CHAIR AND MEMBERS FINANCE AND ADMINISTRATIVE SERVICES COMMITTEE MEETING ON NOVEMBER 26, 2012**
FROM:	**MARTIN HAYWARD MANAGING DIRECTOR, CORPORATE SERVICES AND CITY TREASURER, CHIEF FINANCIAL OFFICER**
SUBJECT:	**TAXATION CHANGES AT THE TIME OF A REASSESSMENT**

RECOMMENDATION

That, on the recommendation of the Managing Director, Corporate Services and City Treasurer, Chief Financial Officer, this report be received for information.

BACKGROUND

Province Wide Reassessment for 2013

For the year 2013, the Municipal Property Assessment Corporation (MPAC) is conducting a Province wide revaluation of all properties in Ontario for the purposes of property taxation in 2013, 2014, 2015, and 2016. The property values will be based on MPAC's determination of property values as at January 1, 2012. For the four years prior to 2013, assessed values have been based on property values as at January 1, 2008.

Reassessments by themselves have no effect on the Revenue requirements of a City and therefore, no effect on the total tax levy imposed by the City. Reassessments do however affect how the total tax levy is allocated amongst the individual properties in the City and between property classes.

In general, properties that increase in value more than the average increase have tax increases related to the reassessment and properties that have increases less than the average increase (or decreases) have tax decreases related to the reassessment. Reassessments can also potentially cause shifts between property classes when average value changes in property classes differ significantly. **Regardless of how much taxes may shift between individual properties and different property classes, the total amount of municipal tax increases related to the reassessment will equal the total amount of municipal tax decreases related to the reassessment.**

Whenever there is a reassessment and during the subsequent phase-in period, virtually no property owner actually receives a percentage tax increase equal to the percentage levy increase approved by Council. This is because the final tax increase a property owner receives results from a combination of three factors as follows:

1. The levy increase approved by Council;
2. The tax increase or decrease resulting from the reassessment (tax decreases from reassessment will equal tax decreases);
3. Changes in education tax rates set by the Province.

Ontario Regulation 75/01 requires that these three factors, as they apply to each individual property, be set out in detail on each property tax bill that a municipality issues.

At the time of a reassessment and during the subsequent phase-in, there can be shifts in taxation between property classes (e.g. residential and commercial) as market values in the various classes change by different percentages. These shifts are reported by staff each year in the annual reports on Assessment Growth/Shifts in Taxation and Tax Policy.

Maintaining Tax Rates After a Reassessment

The suggestion has been made on occasion, that a municipality could follow a policy of maintaining tax rates at the same percentage as the previous year at the time of a reassessment and consider that as not increasing taxation. The problem with such a suggestion is that simple arithmetic makes it obvious that if tax rates remain constant and property values in general go up, then the tax levy of the City will increase in a way directly proportional to the increase in property values. Real estate values are not included in the consumer price index and often behave in a manner very different from the consumer price index, with the result that property taxes could change in a way very different from the consumer price index.

A further consequence of a policy like this would be that reassessments would start to be viewed as a "tax grab" rather than a revenue neutral exercise designed to ensure that property taxes are allocated fairly in a municipality. It should also be noted that Ontario Regulation 75/01 requires all final property tax bills to separately disclose the amount of the levy increase imposed by a municipality on each individual property, as well as any tax change related to the reassessment. Ontario Regulation 75/01 would not permit maintaining tax rates at the previous year's percentage to be interpreted as a 0% tax increase if property values in general are going up as a result of a reassessment.

Recovering the Cost of Inflation in Different Tax Systems

The suggestion is sometimes made that property tax increases should be guided by the level of increase in the consumer price index and increases at or below the consumer price index should not be viewed as "real" increases. The terminology of economists distinguishes between real increases and nominal increases. This terminology is most often encountered in references to GDP. Economists most often track real GDP rather than nominal GDP; the difference between the two being the rate of inflation.

Taxation systems administered by the Federal and Provincial governments are based on income and sales levels in the economy. The revenue from these tax systems automatically grow with the overall economy and therefore grow each year at a rate that reflects both real economic growth as well as the general rate of inflation occurring in the economy. The Federal Government may index tax brackets to prevent movement to higher marginal tax rates but the process of inflation as it is reflected in incomes, still means income taxes automatically increase. The revenue from property tax systems do not automatically grow in the way that income and sales tax systems grow with nominal GDP.

Each year a Municipal Council must set a new levy amount and approve a tax rate. If the Council adopts a policy that the municipal levy on individual properties should not increase even at the rate of inflation, then the result is that the only revenue increase that will occur each year is the increase attributable to the growth in assessment from new construction. This new construction however, is also increasing the requirements for municipal services. The result is that the property tax system levy does not increase at the rate of inflation the way the revenue generated from the income tax systems and the property tax systems automatically do at the Federal and Provincial level of governments.

In order to recover the rate of inflation in the property tax system, Municipal Councils, if they wish to do so, have to take action to approve a levy increase at the rate of inflation. Governments at the Federal and Provincial levels, however, typically need to take no action in order to recover the rate of inflation in the income tax and sales tax systems because inflation is normally reflected in incomes and sales in the economy. It should be noted that economies can experience periods of negative GDP growth and deflation with obvious consequences for income and sales tax systems, but the history of the last seventy years in North America is such periods are not the norm.

In considering the issue of the consumer price index and the rate of inflation, it should be kept in mind that there are different presentations of the index that are discussed. Central banks tend to focus on the “core rate” of inflation for the purposes of monetary policy direction. The “core rate” refers to the consumer price index excluding volatile items such as energy and food. The other version of the consumer price index is often referred to as the “headline rate of inflation” which includes all items and often catches the headline in newspaper articles.

SUMMARY

Reassessments per se are revenue neutral and do not affect the revenue requirements of the municipality. The purpose of a reassessment is only to allocate the City’s tax levy in a fair manner based on a current value of the properties.

Shifts in taxation between property classes as well as individual properties within property classes can occur at the time of a reassessment and subsequent phase-in. These situations are analysed in reports to Council each year on Assessment Growth/Shifts in Taxation and Tax Policy.

Unlike income and sales tax systems that normally grow automatically at the level of inflation and real economic growth, Municipal Councils must approve a tax levy increase if it wishes to recover the rate of inflation in its property tax levy.

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