

2

RECOMMENDATIONS FOR ENDING PROPERTY TAX CAPPING

The Finance and Administration Committee recommends:

1. receipt of the presentation from Ed Hankins, Director of Policy, Risk and Treasury; and
2. the adoption of the recommendations contained in the following report, December 10, 2007, from the Commissioner of Finance:

1. RECOMMENDATIONS

It is recommended that:

1. The Province be requested to amend its tax protection for multi-residential, commercial and industrial properties (“the business classes”) in order to institute the following policies effective for the 2009 taxation year:
 - a) Once a property moves to its actual Current Value Assessment (“CVA”) tax level, the property will remain at its actual CVA tax level in subsequent taxation years;
 - b) The amount of any remaining capping protection or clawback at the end of 2008 be phased-out over a four-year period beginning in 2009;
 - c) Properties in the business classes receive the same phase-in of assessment increments that will be applied to properties in the residential property class; and
 - d) A new optional tool be created to allow municipalities to assist qualified small businesses to defer a portion of the assessment related tax increases remaining at the end of 2008 for a period of up to four years beyond the proposed four-year phase-out period or until the property is sold.
2. The Regional Chair write to the Premier, the Minister of Finance, and the Association of Municipalities of Ontario (AMO) to express Council’s concern and recommendations with respect to property tax capping.
3. The Regional Clerk circulate this report to the Association of Municipalities of Ontario; Association of Municipal Managers, Clerks and Treasurers of Ontario; Municipal Financial Officers’ Association; Association of Municipal Tax Collectors of Ontario and all upper-tier and single-tier municipalities in the Province.

2. PURPOSE

At its September 27, 2007 meeting, Council requested a report on options for ending property tax capping. In addition, further information on rolling-average assessment, the impact of recommending a phase-out of capping on small business, and a

recommendation for tax relief for small businesses was requested by the Finance and Administration at its meeting on November 1, 2007.

This report reviews the history of capping, analyses the effects of capping on multi-residential, commercial, and industrial property classes in York Region, provides recommendations for the elimination of property tax capping, and reviews the impact of phasing out capping on small business.

3. BACKGROUND

When the Province introduced Current Value Assessment, there was a concern that taxpayers in the business property classes would have to absorb extraordinarily high property tax increases as a result of the change in assessment valuation. To mitigate this increase by way of a phase-in, the Province enacted Bill 79, *The Fairness for Property Taxpayers Act, 1998*, introducing the “10-5-5” capping provision to limit the allowable assessment-based annual realty tax increases for the business (also termed “protected”) property classes commencing in the 1998 taxation year. Under this legislation, property tax increases due to property tax reform were limited to 10% of the 1997 annualized taxes, an additional 5% of the 1997 taxes in 1999 and a further 5% of the 1997 taxes in 2000.

3.1 Bill 140 Entrenched Capping

The original term of the legislation implied a three year phase-in but in 2000 the Province enacted Bill 140, the *Continued Protection for Property Taxpayers Act, 2000*. Bill 140 continued the protection for the business classes by limiting the year-over-year assessment related tax increases to 5% on an indefinite basis. Bill 140 also expanded the definition of properties eligible for protection under the “New Construction/ New to Class” provision.

3.2 Municipal Act Amendments in 2004 Move Capping Forward

The Province recognized the concerns of municipalities and provided a partial remedy to capping protection through amendments to the *Municipal Act, 2001* (the Act) contained in the 2004 Provincial budget. In April of 2005, Council approved the use of the full range of capping options available. These options include the following:

- i) An increase to the annual capped taxes from 5% to a maximum of 10%; or
- ii) An annual increase for capped properties of up to 5% of CVA level taxes;
- iii) Moving capped properties (“increasers”) directly to their CVA taxes if capped taxes are within \$250 of the CVA taxes;
- iv) Moving clawed-back properties (those properties in each class that are currently paying more than their CVA level taxes or “decreasers”) directly to their CVA taxes if taxes are within \$250 of the CVA taxes; and
- v) The minimum percentage of CVA taxes to be paid by “new construction/new-to-class” properties is set at 90% of their CVA taxes in 2007, rising to a maximum of

100% in 2008 and beyond. This applies only to new properties in each year and not to properties already capped in prior years.

3.3 Withholding Tax Decreases Funds Capping Protection

York Region, like most other municipalities, funds the cost of capping in each of the protected classes by retaining (clawing back) tax decreases from those properties in the class that are currently paying more than their CVA level taxes (the “decreasers”). The Act also prescribes that the Region must ensure that decreases and increases are equalized across all of the lower-tier municipalities through a process termed “bankering.” Bankering indirectly results in an inter-municipal transfer of tax levy funds to offset capping protection.

If there are insufficient tax decreases available within a given class to fund the amount of protection to the capped properties, there is deemed to be a shortfall in the class that must be funded jointly by the upper and lower-tier municipalities including the educational portion. There were shortfalls for York Region in 2003 and 2004 totalling \$519,026 and clawback rates that exceeded 90% in 2002, 2003, and 2005. When a shortfall occurs, it requires that funds be diverted from reserves or operating programs to meet the capping obligations.

Capping creates taxpayer unfairness by protecting a number of taxpayers at the expense of another group of taxpayers who would otherwise receive reductions to their property taxes payable.

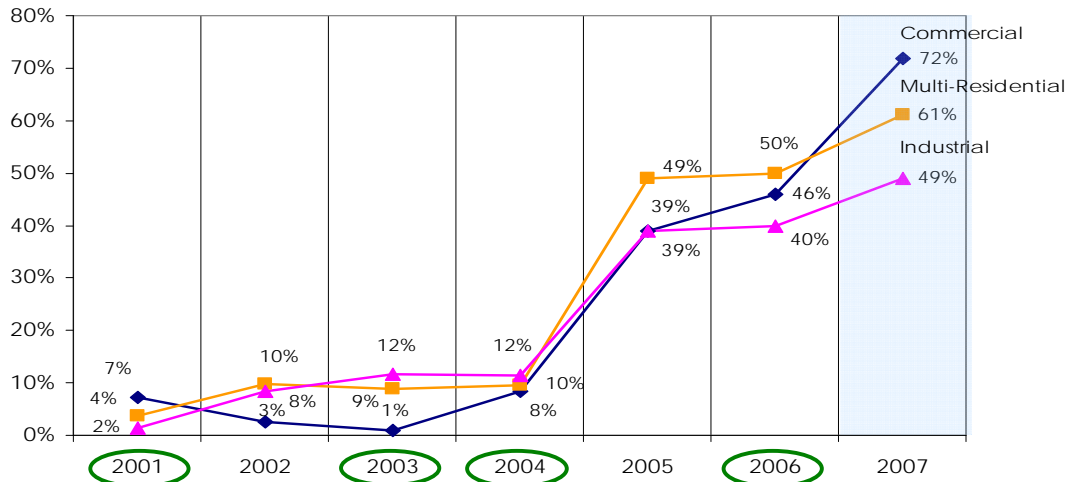
3.4 Reassessment Impedes Progress to CVA Level Taxes

Since CVA was introduced in 1998, there have been reassessments in 2000, 2002, 2003, and 2005. As a result of the March 2007 Budget Bill, the Province has introduced a new four-year cycle for province-wide assessments, commencing in 2008. Further, the Province has dictated that assessment increases for the residential property class will be phased in equally over each of the four taxation years following the assessment year.

As Figure 1 shows, after a reassessment, and despite the capping options adopted by Council, the percentage of properties paying CVA level taxes hardly changes in the following taxation year. As long as the assessed values of the business property classes continue to rise, the negative effect of reassessment is anticipated.

Figure 1 also shows the dramatic impact of the capping options approved by Council in 2005. However, the effect for the 2006 taxation year was a minimal improvement for the multi-residential and industrial classes and a modest improvement for the commercial class as a result of the tax shifts from the 2005 reassessment. Reassessment in 2008 is expected to reduce the impact of the capping options by slowing or reversing the trend to CVA level taxes for the 2009 taxation year.

Figure 1
Percentage of Properties Paying Full CVA Taxes



Note: ○ denotes the year after assessment update year.

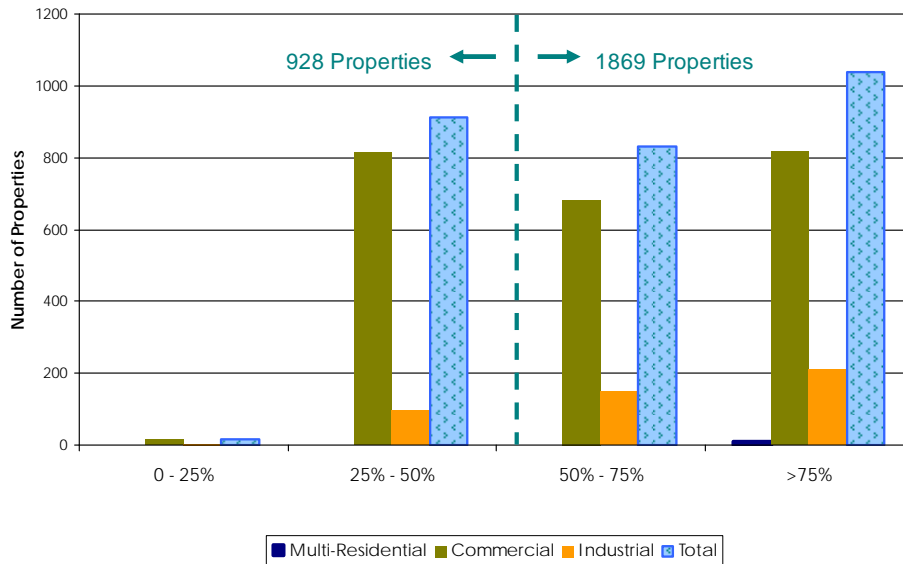
3.5 Capping Protection Perpetuates Taxpayer Unfairness

Figure 1 shows that in 2007, less than half of the industrial class properties are paying taxes at CVA level, less than two-thirds of multi-residential properties at CVA level taxes and less than 75% of commercial properties at CVA. This amounts to 2797 properties remaining capped.

As the province moved through a series of reassessments prior to 2005, any forward movement in the number of business properties being taxed at their CVA level of taxes in non-reassessment years was wiped out by the reassessments, essentially freezing the number of properties paying CVA level taxes at less than 15 percent of the total. After almost a decade of capping protection, there are still over 3600 business property taxpayers losing in excess of \$14 million of tax decreases to which they would otherwise be entitled.

Figure 2 illustrates that more than one third of capped properties pay less than 50% of their CVA taxes in 2007 and 19 properties pay less than 25% of their fair share of taxes. Despite the progress made since capping options were introduced in 2005, the legacy of taxpayer unfairness inherited at the time of tax reform continues.

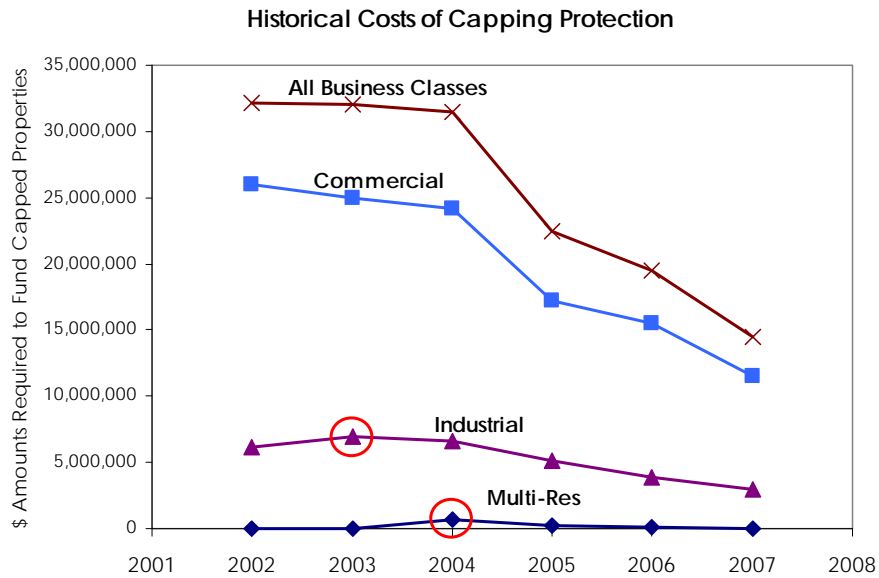
Figure 2
Frequency Distribution of Capped Properties
By Taxes Payable as a Percentage of CVA Level Taxation




3.6 Capping Protection Still Amounts to Over \$14 Million in 2007

As shown in Figure 3, although the amount of capping protection has been decreasing, it still amounts to over \$14 million in 2007. In 2003 and 2004, the Region and all local municipalities funded a total of \$519K due to shortfalls in the decreases available to fund capping protection.

Figure 3



Note:  denotes shortfalls, where the Region and all local municipalities were required to fund a total of \$519K in 2003 and 2004.

3.7 Residential Phase-in May Shift Taxes to the Business Classes in 2009

The Province has announced that the 2008 reassessment increases for the residential property class will be phased-in over a four-year period starting with the 2009 taxation year. While this is intended to dampen the impact of a multi-year reassessment increase on individual properties within the residential class, it will also create the side effect of shifting taxes to the business classes whose assessments are not being phased-in. Any significant increase in taxes to the business classes in 2009 would likely reverse and adversely impact the residential class over the remaining three years of the phase-in period.

In its letter to the Minister of Finance in August of 2007 with respect to Ontario's property tax system, the Ontario Chamber of Commerce noted that the four-year phase-in will create a property tax shortfall causing a tax shift to the business classes.

3.8 The Province Repeals the Three-year Rolling Average Assessment

As part of its 2004 Budget, the Province decided to repeal the previously legislated three-year rolling average assessment as a tool to mitigate the impact of sharply rising property assessments on residential property taxes. This change in legislation had been preceded by extensive representations from the municipal associations including the Association of Municipal Managers, Clerks and Treasurers of Ontario (AMCTO), the Municipal Financial Officers Association, and the Association of Tax Collectors of Ontario.

The position of the AMCTO generally reflected that of the other associations: that the three-year rolling average would confuse taxpayers; other tax mitigation tools could reasonably address the burden of assessment fluctuations and avoid a “one size fits all” approach; the assessment appeal process would become particularly complex; the workload of MPAC would become greater than their capacity to manage; and the implementation of averaging in the commercial and industrial sectors would be extremely problematic. (*Concerns and Observations, Assessment Averaging and Tax Mitigation Tools*, AMCTO, January 2004).

In the Ontario Budget 2004, the Province stated, “It is widely felt that assessment averaging would add complexity to the property tax system, would not enhance fairness for taxpayers, and would be redundant with existing property tax mitigation tools.” (*Ontario Budget 2004: Paper C: Ontario’s Revenue Plan*, p.17) The Province sought tools that would “address taxpayer concerns with assessment volatility for individual properties; ensure fairness for all property owners, both those experiencing increases and those experiencing decreases; and are administratively feasible for municipalities and MPAC.” (ibid, p.18)

In the 2007 Budget Bill, the Province selected the four-year phase-in of assessment increases—for the residential property class (including the farmland and managed forest classes)—as the preferred tool to accomplish the goals stated above.

4. ANALYSIS AND OPTIONS

After almost ten years of capping protection, a significant number of York Region properties are continuing to pay well below their CVA level taxes. The issue is one of taxpayer fairness: the cost of protection afforded to protected properties is borne first by taxpayers eligible for tax reductions (“decreasers”) and then by all taxpayers when a shortfall of decreasers exists.

Progress to CVA level taxes was virtually nil until the introduction of the “new” capping options of 2004. While this relatively conservative legislation is undoubtedly moving up the average tax level of protected properties, after almost a decade, the progress is slow and impeded by reassessments. The Region still retains approximately \$14 million of capping protection, funded by foregone tax reductions.

4.1 Capping Creates an Inter-municipal Tax Shift

By virtue of the “banking function,” capping creates an inter-municipal tax shift in property taxes. The Act requires that the Region act as a “banker” to balance out shortfalls of decreases in one municipality with surpluses of decreases in another municipality. While there is no cost to the Region, when an overall shortfall exists in a property class, the Region and local municipalities share the shortfall proportionately.

The net effect of banking is that taxpayers eligible for refunds in one municipality pay for the tax protection afforded taxpayers in other municipalities.

4.2 The Complexity of Capping Costs Millions

The complexity of the annual capping calculation is so great that the Province had to create the Ontario Property Tax Analysis system (OPTA) at a cost of millions of dollars a year of taxpayer funding. OPTA, at least one sizable private sector firm, and many dedicated municipal employees are required to meet the significant administrative overhead associated with maintaining capping on an annual basis.

4.3 Small to Medium Size Businesses Fund a Large Portion of Capping Protection in the Commercial Property Class

As indicated in the background section preceding, properties that are otherwise eligible to receive tax reductions have a portion of those reductions clawed back to fund capping protection. For example, the commercial broad class clawback rate for 2007 is 74.2% of tax decreases.

Specifically, properties within the property types associated with small business in the commercial property broad class contribute at least half or more of the total dollars of decreases clawed back. The largest single contributor is *small medical/dental buildings* at approximately 24% of the total. This same property type is afforded considerable protection suggesting assessment volatility for this group in particular.

Table 1
Clawback Retention by Top Three Property Types for Commercial and Industrial Properties

Property Type	CVA Level Taxes	Amount of Clawback	Percentage of Total Class Clawback
Commercial Class			
Small Medical/Dental	\$40,483,155	\$2,730,879	23.8%
Industrial Mall	\$22,962,926	\$1,376,253	12.0%
Neighbourhood Shopping Centre	\$14,889,687	\$ 807,791	7.0%
Industrial Class			
Standard Industrial	\$42,750,322	\$1,687,505	57.6%
Industrial Mall	\$9,399,932	\$ 448,926	15.3%
Heavy Manufacturing	\$1,730,051	\$ 315,228	10.8%

4.4 The Impact of the Capping Recommendation on Property Types

The recommended four-year phase-out of capping has the greatest breadth of impact on the commercial property broad class. The following section outlines the property types that would have the greatest increases in tax levels as a result of the recommendations for phasing out capping.

The *commercial condominium, vacant commercial land, and railway buildings and lands* property types comprise 53% or \$6.1 million of the total \$14.5 million of capping protection. Three of the four properties with the greatest capping protection are large corporate and government properties (railway and service centre). Interestingly, the *small medical/dental* property type is over represented with three properties in the top twenty properties with the greatest percentage of protection and 5.7% of the total dollars of protection.

Table 2
Top Three Property Types in Commercial and Industrial Classes
Receiving Capping Protection

Property Type	Total CVA Level Taxes	Amount of Protection	Percentage of Total Class Protection
Commercial			
Commercial Condominium	\$6,263,877	\$2,636,934	23.0%
Railway Buildings and Land	\$5,806,000	\$2,088,211	18.2%
Vacant Commercial Land	\$4,098,384	\$1,356,049	11.8%
Industrial			
Vacant Industrial Land	\$7,080,601	\$2,290,817	78.2%
Other Industrial	\$564,502	\$ 177,460	6.1%
Standard Industrial	\$1,447,998	\$ 174,677	6.0%

For the *commercial condominium* property type, the average amount of protection is \$2083 and the median protection is \$1970.

In the industrial property broad class, *vacant industrial land* represents 78% of the total capping protection and the majority of the top twenty properties with the greatest capping protection. Additionally, a number of these properties are below 50% of CVA level taxes, some as low as 12%. These highly protected properties will require many years under current tax policy to come to full taxation levels.

In the multi-residential property class, there are only ten capped properties, all but one of which would move to CVA level taxes in the next two years without the effect of the next reassessment in 2008. Therefore, the effect of a four-year phase-in would be to extend the benefit of capping protection.

While the instance of small business property types is not extensive in the top quintile of commercial properties with high levels of capping protection, there is the recognition that a four-year phase-in of highly protected properties could represent a burden to some small business property owners.

4.5 Recommended Options for Taxpayer Equity

- 4.5.1 Retain all business class properties at their CVA tax level once this level is achieved to act as a transition step in the phasing-out of capping. As described

above, in a market of rising assessment values, reassessment tends to create new assessment related tax increases subject to capping which impedes progress to CVA level taxation.

- 4.5.2 With 10 years of “phasing-in” CVA increases having already occurred, move all business class properties that are not at their CVA tax level to this level, in equal annual amounts, over the next four year period beginning in 2009. This would be a more equitable method of providing for protection than the current capping program.

Businesses have benefited from capping protection since 1998; however, as of 2007, there are still 928 businesses in York Region that are paying less than 50% of their CVA taxes. By limiting capping to a further four-year phase-out, it will ensure that businesses entitled to tax decreases will no longer be subject to a clawback of the tax decreases owed to them.

- 4.5.3 The multi-residential, commercial and industrial properties should be treated in the same manner as the residential properties with a four-year phase-in of assessment changes beginning in 2009. Applying a four-year phase-in of assessment related tax increases to the residential property class only creates tax shifts between the residential and business property classes over the four-year period. Not only does this perpetuate taxpayer unfairness but an attempt by municipalities to mitigate these shifts is made significantly more arduous.
- 4.5.4 Recognizing that some small business owners may be particularly affected by the proposed four-year phase-out of capping, it is recommended that for the commercial and industrial classes, *if the Province acts to implement a program for the next assessment cycle commencing in the 2009 taxation year*, the Province create a new optional tool to allow municipalities to defer capped taxes for qualifying small businesses. Qualified small businesses could apply annually to defer taxes for up to four years or until a property is sold. At the end of four years, all outstanding taxes would become due but spread over an additional period of up to four years.

As an example, a qualifying small business might be an occupied business property of a specified property type, with a tax capping adjustment (taxes protected by capping) greater than 50% of CVA level taxes, and a CVA of less than \$1 million. However, a full analysis of potential beneficiaries would need to be conducted prior to final recommendations for such a program.

The following table provides a summary of the proposed options using the 2797 properties capped as of December 2007 as an example.

Table 3
Summary of Proposed Capping Phase-out Options

Phase-out Methodology	Application	Capping Protection, December 2007	Estimated No. of Properties Affected as of December 2007
Current			
"10/5/250/250"	All business properties*	Less than 30%	1172
Four-year phase-out	All business properties*	30% or greater	1625
<i>The following represents small businesses that could potentially qualify for a deferral program—approximately 750 of the 1625 properties with protection 30% or greater.</i>			
Eligible for a Deferral program	Qualified small business properties	Greater than 50%	750

* 2797 total number of capped business properties in 2007.

Properties with capped taxes less than approximately 30% of CVA level taxes will move to CVA level taxes within four years under the current capping options. Using the current "10/5/250/250" cap option, properties with capped taxes in excess of 30% of CVA level taxes may create more total clawback retention before reaching CVA level taxes and therefore the four-year phase-out ensures that fewer dollars are clawed back from properties eligible for decreases.

A cap of 20% (instead of "10/5") was used to model a deferral program for small business. Using this cap, properties with a capping adjustment (capped taxes) in excess of 50% of CVA level taxes will benefit from a deferral of the difference in taxes payable between the 20% cap and the four-year phase-out. The deferred taxes from the first four years would be repaid in the subsequent four years.

- 4.5.5 Tinkering with "new" capping options is not recommended. This legislation perpetuates a complex and unfair process, which is set back with each new reassessment and carries a high administrative overhead (e.g. OPTA). The legislation should simply be phased-out.

5. FINANCIAL IMPLICATIONS

There are no financial implications arising directly from this report. The effect of capping is to prevent taxpayers who are otherwise entitled to tax decreases from receiving their full decreases. Further, if there are insufficient tax decreases available to fund capping protection, all taxpayers in the Region fund the shortfall through the utilization of reserves or reduction of expenditures.

If a deferral mechanism is chosen at a future time, there would be some additional cost associated with the deferral program during the period in which the taxes have been deferred.

6. LOCAL MUNICIPAL IMPACT

While the decrease of capping protection has reduced the overall inter-municipal banking requirement, reassessment in 2008 could adversely affect this trend. The effect of a shortfall at the local municipal level is the same as presented at the Regional level above. As indicated in the preceding section, if a deferral program is introduced there would be some additional cost to local municipalities.

7. CONCLUSION

While Bill 79 or the “10-5-5” provided a reasonable transition to CVA taxation, the introduction of Bill 140 in 2000 entrenched the assessment inequities present at the time of property tax reform in 1998. There was little progress in moving properties to CVA level taxes until the introduction by the Province in 2004 of the new capping options for the 2005 taxation year.

These new options have significantly improved the movement of properties to CVA. However, there are many “protected” properties paying well below CVA level taxes and conversely, many other taxpayers in the business property classes not receiving the tax reductions to which they are entitled.

To support the Provincial capping policy requires millions of dollars a year to pay for OPTA, substantial amounts paid to private service firms to assist some municipalities with capping calculations and policy, and a sizable commitment of municipal staff resources to deal with capping policy, calculation, and billing issues.

In a market of rising assessment values, experience has shown that reassessment tends to freeze progress to CVA for at least one taxation year. With four-year reassessment cycles, the effect of reassessment will be even more prolonged than in the past. A short-term solution would be to have properties remain at their CVA level tax once they have reached the CVA level tax.

It is also recommended that in the longer term, capping be terminated over the next four year reassessment cycle commencing in 2009, consistent with the residential phase-in, to restore taxpayer fairness to the business property classes. Further, the same phase-in of assessment increases should apply to the business property classes to provide equity across all property classes and facilitate tax planning at the municipal level.

The report also shows that in the commercial property class, property type codes associated with small businesses and individual small business properties are not strongly represented in the group receiving maximum capping protection. In fact, large utilities and vacant land consume much of the capping protection.

However, some small business owners may be particularly affected by a four-year phase-out of capping. If the Province acts to implement a program for the next assessment cycle commencing in the 2009 taxation year, it is recommended that for the commercial and industrial classes, the Province create a new optional tool to allow municipalities to assist qualified small businesses to defer a portion of the capped taxes for a period of up to four years beyond the proposed four-year phase-out period or until the property is sold, whichever is less.

The Senior Management Group has reviewed this report.