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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. **referral of the following report, October 4, 2007, from the Commissioner of Finance back to the Commissioner for a report to the December 13, 2007 meeting of Regional Council.**

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 years;
   b) The amount of any remaining capping protection or clawback be phased-out over a four-year period ending in 2012; and
   c) The business classes receive the same phase-in of assessment increments that will be applied to properties in the residential property class.

2. The Regional Chair write to the Premier and the Minister of Finance 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. This report reviews the history of capping, analyses the effects of capping on multi-residential, commercial, and industrial property classes in York Region and provides recommendations for the elimination of property tax capping.

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.

Bill 140 Entrenches 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 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.

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.
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.

Tax Decreases Fund Capping Protection

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

If there are insufficient tax decreases available in a given class to fund the amount of protection to the capped properties, there is 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 balance the annual budget.

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.

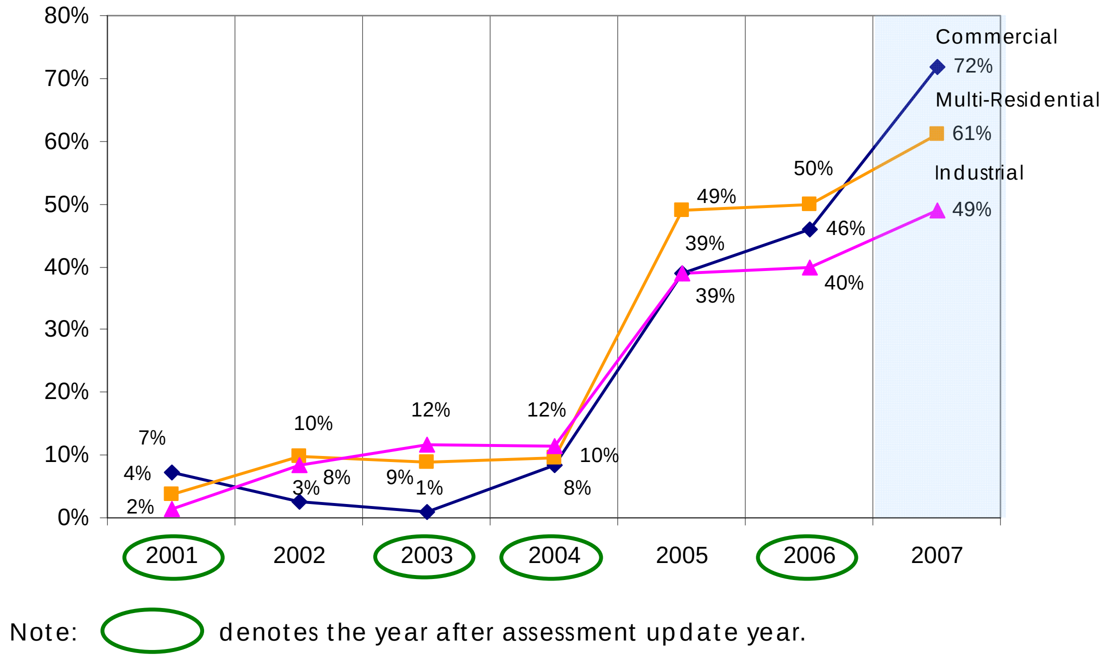
Reassessment Impedes Progress to CVA Level Taxes

Figure 1 shows the dramatic impact of the introduction of the full capping options in 2005. However, 2005 was also an assessment year which had the effect that for 2006 there was a minimal improvement for the multi-residential and industrial classes and a modest improvement for the commercial class. The figure also illustrates the lack of progress towards CVA level taxes that was experienced in York Region prior to the application of the new capping options in the 2005 taxation year.

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.

Figure 1

Percentage of Properties Paying Full CVA Taxes



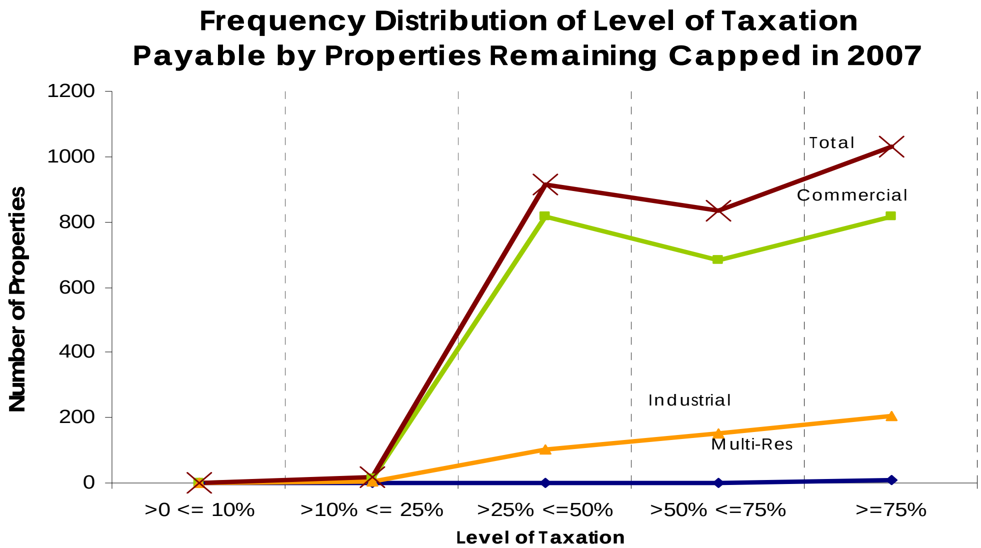
Capping Protection Perpetuates Taxpayer Unfairness

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 over 3600 business property taxpayers losing in excess of $14 million of tax decreases to which they would otherwise be entitled. Each reassessment reduces progress toward CVA with a similar result anticipated for the 2008 reassessment.

Figure 1 shows the discrepancies between property classes, with less than half of industrial class properties at CVA level taxes, less than two-thirds of multi-residential properties at CVA level taxes and less than 75% of commercial properties at CVA.

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.

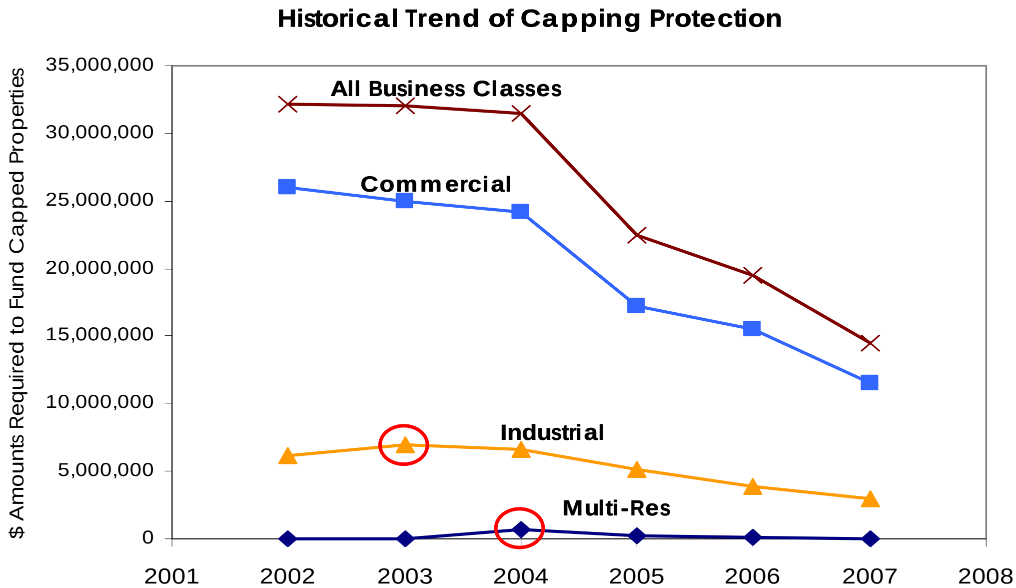
Figure 2



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.

Reassessment Affects the Trend to Lower Capping Protection

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. Reassessment resets the assessed value of properties and therefore resets the capped tax level of the properties.

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.

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 would also create a 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.

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 refunds.

Capping Creates an Inter-municipal Tax Shift

By virtue of the “bankering function,” capping creates an inter-municipal tax shift in property taxes. The *Municipal 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 bankering is that taxpayers eligible for refunds in one municipality pay for the tax protection afforded taxpayers in other municipalities.

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, a 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.

Options for Taxpayer Equity

1. Retain all business class properties at their CVA tax level once this level is achieved. This option will overcome the reset action associated with reassessment years and act as a transition step in the phasing-out of capping.

2. With 10 years of phasing in of 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 ending 2012.

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 for 2008.

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, after 10 years of protection, there are still 916 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 other businesses will no longer be subject to a clawback of the tax decreases owed to them.

4. 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 to offset the shortfall in property tax revenue.

6. LOCAL MUNICIPAL IMPACT

While the decrease of capping protection has reduced the overall inter-municipal bankering 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.

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. There was little progress in moving properties to CVA level taxes until the introduction of the new capping options in 2004 for the 2005 taxation year.

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

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 potential effect of reassessment could be even more dramatic than in the past. A short term solution would be to **have properties remain at CVA level taxes** once they have reached CVA level taxes.

It is also recommended that in the longer term, that capping be phased out over the next four year reassessment cycle, consistent with the residential phase-in, to restore taxpayer fairness to the business property classes.

The Senior Management Group has reviewed this report.