HRM Tax Reform Assessment

Background

Over the past few years, feedback from businesses and business advocates – corroborated by the Partnership – has identified key issues with the Municipality's tax system (see below). Regional Council directed municipal staff to consult and analyze potential solutions. Staff noted that the city did not have the tax tools to address these issues properly. Therefore, on November 10th, 2015, Regional Council directed the Mayor to write a letter to Municipal Affairs and request additional taxation powers.

In response, the Minister for Municipal Affairs introduced *Bill-177* and *Bill-52, Acts to Amend Chapter 39 of the Acts of 2008, the Halifax Regional Municipality Charter*. While *Bill-177* granted some specific powers for individual commercial properties, *Bill-52* granted more substantial and general commercial taxation powers. *Bill-52* was also amended by the BIDs' public input to grant an additional power. By November 10th, 2016 both bills had undergone third reading and achieved Royal Assent, making them law.

This paper will begin to address the following questions: What powers did the Municipality ask for and/or receive? Can any of these new powers address the original issues? What are some of the potential (un)intended consequences of implementing these new powers? Given this information, a central concern will be how the municipality uses its new taxation powers effectively.

Key Issues

Feedback from the Halifax business community has brought to light some key issues in Municipal Taxation. Three issues have recently been raised by local businesses and BIDs: tax fairness, tax volatility, and city planning. Additionally, the Municipality has its own concerns about its taxation powers and how they affect the city's ongoing operating costs.

Tax Fairness

Many businesses consider commercial property taxes unfair or prejudicial towards small business. Their chief concern is that the taxation system does not accurately reflect a business' ability to pay for those taxes. Most proponents for this issue suggest some sort of preferential treatment for 'small' businesses.

Tax Volatility

Some businesses in Halifax are worried that new developments can cause sudden changes to tax assessments of nearby businesses. These changes can suddenly increase tax liability before commercial traffic in the area improves, which can create liquidity issues for the existing businesses.

City Planning

The BIDs have expressed their concerns with the current distribution of commercial development in Halifax. They are worried by how many office and retail tenants are migrating to more suburban business parks with cheaper land values (and assessments) such as Dartmouth Crossing. Their main proposal is that more favourable tax rates for commercial offices in the Regional Centre will more properly align with the city's long term planning goals. Primarily, they argue that it will be more effective to allocate industrial developments to the industrial parks and office spaces to the high-density regions of the city, promoting growth and better city planning.

Operating Costs

The Municipality has an ongoing concern with how the level of commercial development in Halifax affects both its top and bottom lines. New businesses and residents need costly municipal services. However, these developments may not proportionately create tax revenues to pay for the services. The Municipality is concerned with how its tax tools can generate sufficient revenues to cover its costs while not unduly discouraging growth.

Assessment of New Tools

This section analyzes each of the requested tax powers from a theoretical standpoint. The specific language used in *Bill-52* is attached in Appendix A, with a brief description in Appendix B. The table below summarizes which new powers *Bill-52* granted and how each of the requested powers may be used to address the key issues. While the Municipality originally sought these powers for both residential and commercial properties, *Bill-52* only grants these new powers for commercial properties. Each power was assessed using the following metric:

- **Effective**: If implemented properly, this power could be effective in addressing the key issue. However, this may involve large-scale changes to HRM's existing commercial tax system to be fully effective.
- **Partial**: This power may partially address a key issue, but would require the use of additional powers implemented in tandem, or very specific uses of the power in question.
- **Concerns**: This power may partially address a key issue, but will likely cause unintended economic consequences. Very specific uses of this power may be fruitful, but careful consideration is needed.
- **Blank**: This power does not effectively address this key issue.
- **Harmful**: This power likely has negative consequences for one of the key issues.

Requested Powers	Granted Powers	Key Issues			
		Fairness	Volatility	Planning	Costs
Tax Averaging	No		Effective		
Infrequent Assessment	No		Concerns		Harmful
Regional Rates	Yes			Effective	Partial
Categories/Size of Business	No	Concerns		Concerns	Partial
Class of Building[1]	No	~	~	~	~
Size of Structure	Yes			Concerns	Partial
Size of Property	Yes			Concerns	Partial
Frontage Size	Yes	Harmful		Partial	Partial
Base Charge per Property	No	Harmful			Harmful
Base Charge per Dwelling	No	Concerns		Concerns	Concerns
Minimum Charge	No	Harmful			
Maximum Charge	Yes*		Concerns	Concerns	Harmful
Graduating Rates	Yes	Concerns	Concerns	Concerns	Concerns
Surtax	No	Harmful		Concerns	Partial

*While this power is not explicitly granted by Bill-52, other powers can be used to effectively replicate it.

Importantly, to act on any of these powers, certain data will be required. The Nova Scotia Property Valuation Services Corporation (PVSC) provides data to the city of Halifax. Their databases would provide the necessary data for the requested powers with a few exceptions. These concerns present some limitations on how the requested and/or granted powers may be implemented and have been accounted for in the analysis below:

- For some *Income Stream*[2] properties, the measured square footage of a building does not include common rooms or shared facilities. Only the total amount of leased/leasable space is measured.
- For some Income Stream properties, the measured leasable space is not distinguished between individual owners. Therefore, property taxes cannot be levied proportionally to tenants or sub-owners of a property.
- Data is not available on the frontage of a property. However, it may be possible to gather these data through GIS technology or pictometry data that are currently available to the city.

[1] It was unclear from the language of the Council motion how this requested power would be defined or what it was asking for. No analysis could be provided given the lack of detail.
[2] Income Stream properties refer to buildings whose worth is determined by their ability to lease space and earn income over time, e.g. Apartments, Office Buildings, or Hotels.

Synopsis

Tax Fairness*: There are serious concerns about resolving this issue with any of the requested or granted powers. Non-property taxes (e.g. Corporate Income Tax) would likely be able to accomplish the task with fewer drawbacks.*

Tax Volatility*: Tax Averaging represents a valuable tool for combatting the volatility faced by businesses, but the power was not granted to the city. Other potential solutions such as a hard or soft cap could address the issue but would introduce significant unintended consequences and are not advised.*

City Planning*: Area rates that promote denser use of economic resources and central commercial corridors will be a trade-off between lower overall rates and higher economic activity. This option is worth exploration but is untested empirically and will require careful consideration.*

Operating Costs: *Frontage-based taxation tools worsen the issue of tax fairness and may distort where businesses are developed throughout the city. Regional rates may be used to help the city grow in a more fiscally sustainable way, but this will require deeper analysis to target properly.*

Summary by Key Issue

Tax Fairness

To properly grapple with this issue, a tax system must allocate taxes based on a company's ability to pay. Typically, this is expressed as a difference between "small" versus "large" businesses, where large businesses are perceived as more able to afford property taxes. However, there are some significant difficulties with this task, as there is not a clear correlation between ability to pay and property ownership.

In a broader context, there are also concerns about how the benefits of taxes correlate with who pays for them (often called "user-pays"). However, the businesses at issue with the commercial tax system were chiefly concerned with inequality around ability to pay.

Given the available powers, the city could potentially introduce graduated rates – either based on frontage, square footage, and/or assessed value – which mimic a progressive[3] tax system. This would mean that companies who used less space or had a lower assessed value would pay a smaller share of their overall size/value. The difficulties with this approach are threefold:

- Fairness (Horizontal Equity): Companies of similar ability to pay may have dramatically different needs for property. Goods manufacturing and industrial companies will require a larger and more expensive overall footprint than service companies as part of their production process. Introducing preferential rates for those who use less property would be prejudicial towards companies who need a larger building for industrial utilization. A distinction would need to made between industrial, office, and/or residential uses; however, this taxation power was not granted.
- Substitution: It will be relatively easy for a company to change its behaviour to avoid the progressivity of this kind of tax system. Owners may split their company into small business units to avoid higher tax rates. Similar issues have been observed with the Corporate Income Tax system, both empirically and theoretically. This kind of substitution also comes with additional economic costs as it interferes with a company's economies of scale. Companies can also choose to outsource their operations to other cities or regions and minimize their local impacts and avoid higher tax rates. Taxes on larger properties may also discourage density, as property developers spread their commercial development space over a larger number of smaller properties to reduce their tax liability per unit of revenue.

[3] A tax system is deemed *Progressive* if the average tax rate increases as the tax base increases. E.g. A $100,000 property ends up paying 3% of that $100,000 in taxes while a $500,000 property ends up 5% of that $500,000 in taxes.

- Administration: It is very difficult to effectively distinguish between businesses which can afford to pay versus those that cannot. While it may be possible to distinguish a small business from a large business (through employment, revenue, etc), how this correlates to property ownership is unclear. A larger business will not necessarily have a single property that is larger than a smaller business, as they may use chains of smaller outlets for property instead. Additionally, larger properties may not be occupied by a single large company, but by several small companies with less ability to pay. These higher tax rates will translate into higher rents for the small tenants. Data does not allow PVSC or the Municipality to distinguish between individual owners within a larger *Income Stream* property.

Addressing the issue of Fairness with any sort of combination of property tax powers would be difficult. Substitution and Administration are serious concerns with a variety of interweaving outcomes in terms of utilization, economies of scale, and development. While this analysis makes tackling the issue of Fairness seem like an impossible task, this is not the case. Property taxes may simply be the wrong type of tax system to address issues of equity. The municipality may choose to rely on other parts of a company's tax bill to solve these inequities. For example: other forms of taxation at the provincial level such as Corporate Income Taxes already have significant differences in tax rates based on net revenue and business size.

Examples

The City of Toronto has used graduating tax rates on residential properties and a select few "residual commercial" properties since 2008. This includes most commercial properties that are not "Large Office Buildings, Large Shopping Centres, Large Sporting Complexes, Large Theatres, or Parking Lots". To support small businesses, it has applied a small tax rate differential for the first $1 million of the property's assessed value. However, Toronto and Smiths Falls appears to be the only Canadian Municipalities that have adopted this policy. Several municipalities have rejected or opted out of adopting this sort of reform due to the inability to correctly target smaller businesses and administrative difficulties[4].

Tax Volatility

To address the issue of tax volatility, there are two main approaches. The tax system can be made more predictable, and/or less volatile. While issues of predictability can be addressed by forecasting changes to the tax system and municipal plans, this does not sufficiently address the issue.

Business owners are concerned about the volatility introduced when a nearby area is developed. Development agreements and municipal planning changes can lead to unexpected changes in land and property values. Increasing the maximum height of a property may benefit the landowner in terms of a windfall gain in asset value, but this also increases taxed owed on the value of that asset. Similarly, building an expensive new development on a nearby lot can sharply increase the assessments of existing properties.

This puts pressure on existing business owners to sell, as they experience higher taxes from higher assessed values, but only capitalize the gains on their land when they sell their property. It also hurts tenants who see the higher taxes passed down to them in the form of higher rents but do not immediately see the gains from increased density or commercial traffic. During this initial period, the changes to the land value are speculative, as they have not yet translated into increased economic activity or real value to the business itself.

Looking only at the granted powers, the city has been given two blunt instruments for addressing this issue. The first is to introduce some sort of maximum for property taxes. This will mean that sudden increases to assessed value will not be reflected in increased property taxes owing. However, much like an assessment cap, this does not actually provide a solution as it limits overall revenues for the city. The additional revenues must be made up somewhere, leading to either general rate increases or redistributing taxes onto other properties. The second

[4] For example, see the City of Brantford's 2015 Tax Policy Assessment (link). Other examples included Hamilton, Niagara, Muskoka, and Peel Region.

approach would be to provide a graduated (and lower) rate on assessed value over and above last year's assessed value. This would require a charitable reading of the legislation, but would also introduce similar issues as a maximum. Revenues would be lower and the difference would need to be made up with higher overall rates.

Expanding our analysis to requested powers, one power could be used fruitfully to address this issue: Tax Averaging. This would mean that instead of using the latest assessment, a property owner would owe taxes on the average of the past number of years' (e.g. 3 years) assessments. Therefore, if a property were to have a sudden change in its assessment, the taxes owing on that change would be realized over the next few years. This "takes the edge off" the change by shifting the burden and volatility from the business to the Municipality. As a large organization, the Municipality is in a better position to bear the risk/liquidity issues than a small business. Unlike hard or soft caps, all the tax is collected eventually, which means that rates do not have to be raised to recover for lost revenue. While this would be the ideal tool to confront issues of volatility, the power was not granted.

Examples
The Province of Saskatchewan provides its cities with the ability to phase-in a share of their property taxes over a period up to 4 years. This tool is mathematically identical to Tax Averaging discussed above. Regina has used the tool since 1997 and is scheduling a review in 2017. The city has adopted principles for its implementation: It must be revenue-neutral, simple (both in administration and compliance), and must promote stability. The phase-in tool and its principles received unanimous support from council and support from the larger business community. This tool is also available to Municipalities throughout Ontario, though it is not widely used in that province.

Toronto has had a 5% hard cap on commercial tax increases since 2006. However, since 2009 it has been phasing out this policy as it tries to slowly remove properties from the system. The Province has granted Toronto the ability to increase its capping rate to 10% to expedite the process.

City Planning
One of the growing concerns, especially among the Business Improvement Districts (BIDs), is that the development and occupancy of new commercial properties does not align with the city's overall plans. While the city is looking to promote urban and main corridor density for its economic advantages, many offices and commercial properties are opting to move out to business parks where land is less expensive. While this discourages more intense use of economic resources and often requires costly expansion to municipal services, it has nevertheless been the trend.

One approach to combat this trend would be to set tax collection quotas for specific service areas, establishing a given volume of taxes that must be collected among all businesses within the area. Theoretically, this encourages businesses to move to areas which are more densely packed, as they must pay a smaller share of the total. While this method may directly encourage dense utilization of resources, it is administratively difficult to implement and is largely untested, both theoretically and in practice.

An administratively simpler alternative has been promoted by the BIDs: identify specific areas of high density and set lower commercial property tax rates in those areas. This would encourage more utilization of those dense corridors. The drawbacks of this approach are similar to capping assessments: they reduce necessary revenues to the city and require overall rates to rise to compensate for the loss. However, the increased densification will also promote higher property values and economic activity. Therefore, one should consider this tool as a trade-off between lower tax rates and higher economic activity. How this is applied in Halifax is an untested empirical question, which would require further study before proper implementation. Some additional thought should also be put into how to treat businesses on the border of these geographic boundaries. There may be tools such as buffer zones or select regions based on service areas that would mitigate some of these concerns.

Example
Montreal provides several different tax rates for different areas within the larger municipality. This is less of a policy tax choice, and more of a reflection that there are sub-Municipal governments throughout Montreal. Different boroughs or regions are represented by different organizations and therefore pay different area rates.

Operating Costs.
One of the Municipality's chief concerns is how it can afford public amenities. The organization relies on property taxes as a way to finance key (and often essential) services. While the Municipality is supportive of overall economic growth, new businesses and residences drive costs for the city. Accordingly, its tax system should not discourage growth but should share in some of that growth's benefits. Achieving this balance is made more difficult with the city's limited tax tools.

One method to achieve this goal is to try and closely align the Municipality's costs with its tax revenues, such as through a tax on frontage. While street frontage typically scales proportionally with Halifax's capital costs[5] (sewers, road paving, etc), it should not be thought of as a user fee. While the costs borne by the Municipality scale proportionally to frontage size, the benefits to the property owner do not. Some clear examples of this would be:

- Fairness (Vertical Equity): Consider two adjacent properties of the same size and frontage; where one building is a ground floor commercial storefront and the other is a 20-storey office building. The office building will be a much greater user of services than the storefront. It would be inequitable to charge these two businesses an equal amount of property tax.
- Fairness (Horizontal Equity): Consider two identical businesses on identical size properties, with the exception that one is a corner lot and the other is not. The businesses have equal needs and see equal benefits from public services, however one would have twice the tax liability of the other due its increased frontage. While the corner business may receive slightly more foot traffic (which would be reflected in an increased assessment value), the proportion of frontage does not scale with its needs or the cost it incurs to the Municipality. This also introduces another complication, see Substitution.
- Substitution: If a property tax system were to be introduced based on frontage, it would be likely that corner lots would quickly be vacated. There would be a significant incentive for businesses to move their operations to a property that had a smaller frontage. This would lead to businesses occupying more city-space and driving costs higher, as well as leaving lots of empty corner lots throughout the city.

Looking back at the discussion on City Planning, the Municipality may be able to use Regional Rate tools to align costs with economic growth. The city can reduce cost-pressures by identifying areas with excess infrastructure capacity and setting rates to incentivize businesses to fill that capacity. This would likely require a lot of consideration and may cause frequent changes to tax rates as excess capacity is filled.

The clear drawback of this approach is that it improperly targets businesses. To incentivize growth in a specific area, tax rates in that area must be lowered. However, rather than just lowering the tax rate for prospective businesses, it also lowers the tax rates on existing businesses. This means that it is very expensive to create a sufficiently impactful incentive for businesses looking to relocate.

Examples
Winnipeg, Manitoba and Stratford, Prince Edward Island levy property taxes for water and sewer services based on the frontage of a property, though it is a very tiny share of their property tax system. Glovertown, Newfoundland applies a frontage based tax on vacant land to discourage vacant properties from taking up space.

The City of Ottawa uses area rates, not to promote density, but to better align property taxes with the level of transportation services. Geographic areas are assigned a level of public transit service and all homes and businesses in that area have a transportation levy (a higher tax rate) applied to reflect that level of service. There are many other potential uses for area rates which merit consideration. Similar charges exist for school areas across Canada, where different districts charge a levy to pay for local schools.

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[5] For details on why this is the case, see *Quantifying the Costs and Benefits to HRM, Residents and the Environment of Alternative Growth Scenarios*; Stantec, April 2013.

Appendix A – Council Motion

Approved on November 10, 2015

MOVED by Councillor Mason, seconded by Councillor Watts

THAT the motion be amended so that Halifax Regional Council direct the Mayor to write the Minister of Municipal Affairs to:

1. Request that the Provincial Government, in order to increase predictability for taxpayers, consider making changes to the legislation governing the assessment process so that:
    a. The annual valuation is averaged over a three year period or,
    b. The full assessment roll is updated every three to four years, as is the current policy in Saskatchewan and Ontario.
2. And to request amendments to the Halifax Regional Municipality Charter that would provide Council with greater legislative authority in setting taxes and charges respecting the general tax rate and area rates for both residential and commercial properties including
    a. The authority for Council to determine and set rates and charges that are different for:
        i. Different areas of the Municipality
        ii. Different categories and size of businesses, and
        iii. Different classes of building and size of structures, and
    b. The authority for Council to determine and set:
        i. A rate or charge for frontage on a street
        ii. A uniform charge or amount of tax that is payable per property or per dwelling unit
        iii. A maximum and minimum charge or amount of tax that is payable, and
        iv. A surtax or graduated rates.

Appendix B – Glossary of Powers

Definitions

Tax Averaging – This system calculates property taxes owing based on the mean of the previous X years assessed values, rather than the current year's assessed value. For example, consider a 3-year tax averaging system and a property that was worth $60k. However, in 2012 its assessment jumped to $90k and then returned to $60k the following year. Its taxes owing would be based on the following assessments:

Year	2009	2010	2011	2012	2013	2014	2015	Total 2009-15
Base Assessment	$60k	$60k	$60k	$90k	$60k	$60k	$60k	$450k
3yr Tax Averaging Assessment	$60k	$60k	$60k	$70k	$70k	$70k	$60k	$450k

As you can see, in the long term the total between the two systems is the same. However, the Tax Averaging system ensures that any spikes or sudden changes to a property's assessment are phased in gradually.

Infrequent Assessment – This system decreases the frequency at which a property's assessment is revaluated and relies on previous years' valuation to determine taxes owing. Consider the example above, but with a 3-year infrequent assessment or a 4-year infrequent assessment:

Year	2009	2010	2011	2012	2013	2014	2015	Total 2009-15
Base Assessment	$60k	$60k	$60k	$90k	$60k	$60k	$60k	$450k
3yr Infrequent Assessment	$60k	~ (60k)	~ (60k)	$90k	~ (90k)	~ (90k)	$60k	$510k
4yr Infrequent Assessment	$60k	~ (60k)	~ (60k)	~ (60k)	$60k	~ (60k)	~ (60k)	$420k

The system does not respond well to spikes in the assessment year and it completely misses assessment changes in off-years. The advantage of the system is that it is administratively easier and requires fewer resources to manage and assess properties.

Regional Rates – This allows Council to choose specific area(s) within the city and apply a different set of tax rates to properties in each area. For example, it may choose to have lower property tax rates on properties along a specific commercial corridor or region of the city.

Categories/Size of Business – This allows Council to set different tax rates to businesses of specific types or sizes. For example, it may choose to have a lower rate for industrial businesses and a higher rate for office businesses. It may also choose to set property tax rates based on the number of employees who work at the property or the number of employees who work for the property owner.

Size of Structure – This method of evaluation sets a specific tax rate per square foot of building space on a property. This is used to reflect the total utilization of a property, with larger buildings incurring larger taxes. For example, applying a rate of $1.00 per square foot would mean that a 5000 square foot structure with 5 floors would owe $25,000 in taxes.

Size of Property – This method of evaluation sets a specific tax rate per square foot of the lot size. For example, applying a rate of $1.00 per square foot would mean that a 300 by 200 foot property would owe $60,000 in taxes, regardless of the size of the structure on that property.

Frontage Size – This method of evaluation sets a specific tax rate per foot of property adjacent to a public or private roadway. It measures how much of the property (not the building) touches public space and is meant to represent how much additional roadway the property requires the city to maintain. For example, a 500 by 500 foot property with a road on one side would have 500 feet of frontage, while the same property on a corner lot would have 1000 feet of frontage. If a tax of $3.00 per foot of frontage were applied, the first building would owe $1500 and the second would owe $3000.

Base Charge per Property – This is set amount of taxes owed on each property, above and beyond any taxes owed due to assessment value or other tax tools. It can be thought of as the starting amount of taxes that a property owes before any other kind of property tax is calculated.

Base Charge per Dwelling – This is a set amount of taxes owed for each dwelling on a property. For example, a base charge of $100 per dwelling would mean that a 200-unit apartment building owes $2000 before the rest of its taxes are calculated.

Minimum Charge – This is a floor on the amount of tax dollars owed across any situation. For example, a minimum charge of $4000 would mean that if any property would otherwise owe less than $4000 in taxes, they would owe $4000 instead.

Maximum Charge – Like a minimum charge, a maximum charge puts a cap on the total amount of taxes owed by a property. If a maximum charge were set at $2,000,000 and a property owed $94,000,000, they would instead be charged $2,000,000 instead.

Graduating Rates – This is a tax rate that increases (or decreases) as the amount subject to taxation increases. For example, a tax rate may be set at 5% on the first $1,000,000 of assessed value and 10% on any assessed value above that. So a $3,000,000 home would pay $50,000 (1mil*5%) on the first $1,000,000 of assessed value and $200,000 (2mil*10%) on the next $2,000,000 of assessed value; it would owe $250,000 total in taxes. This scaling up (or down) of the tax rate is called a Graduating rate.

Surtax – A surtax is a lump-sum amount of taxes owed that occurs when a specific condition it met. For example, there may be a $500 surtax on red buildings. If a building is red when its property taxes are due, it would owe an extra $500.