



COUNCIL FOCUS AREA

TAXATION

Background and Discussion Paper

January 17, 2006

1. INTRODUCTION

Background

- Throughout most of North America municipalities use taxes on property values as their chief source of revenue. Historically, property values were used because of their perceived link to income and wealth. Hence, the original rationale for property taxation was that it reflected one's ability to pay. As municipal services became more critical to everyday life, the value of property was sometimes affected by the services themselves. Property tax was seen to reflect not only one's ability to pay but was also considered to reflect the value of the municipal services that one might use.
- In HRM, some elements of the current revenue structure have been designed so as to adjust for differences in the level of services. For instance, HRM has three general tax rates: urban, suburban and rural. Some services are funded from area rates (supplementary education costs, sidewalk plowing, crosswalk guards and hydrants) hence ensuring that only areas with a service pay for it. Other services are paid for by user fees (eg water and sewer) which are levied on those with direct access to the service. The property tax system also includes residential tax rebates and deferrals that are available to low income individuals. This assistance helps those individuals that have a weaker ability to pay.
- Many of these elements were designed at different points in time and in response to differing concerns. To date, there has been no systematic review of the premises behind the entire revenue structure. In some respects this is perfectly understandable. The rules for assessment and restrictions on what can be taxed are established by Provincial legislation. HRM has almost no say in the structure of the assessment and tax system.

Current Issues

- In the last several years there has been a concern in many areas regarding the current system and its impact in some areas of HRM. These concerns spring from a number of different sources. In some areas of the municipality property values have risen sharply over a short period of time even though service levels have often not risen at the same rate. In rural and suburban parts of HRM there are fewer locally available services than in the more urbanized areas leading to concerns over fairness. Overall, HRM is expected to grow rapidly over the next 25 years. The current system does not allow for any incentives to support this growth and may even disadvantage more efficient forms of growth. All of this has led many to questions whether the burden of taxation has been fairly distributed.
- Council has expressed a number of concerns over the functioning of the current tax system. In April of 2004 Council asked staff to investigate alternatives to the property tax

system. Later that year staff proposed a broad based revenue strategy to do an overall review of the revenue system. One of the chief objectives is to seek an appropriate balance between reliance on the market-based assessment system and other forms of taxation and charges.

- Any review of the tax system carries with it a number of risks that it must overcome before it can be successful. First of all, HRM has no authority to alter the overall tax system. It must request legislative changes from the Province, which in turn is not obligated to do so. Secondly, there may be unrealistic expectations of the impact of any tax changes. Everyone's tax bill cannot decline. For every dollar one individual saves, someone else must pay an extra dollar in tax. Fairness is not simply, or at all, about paying less and getting more. While criticism of the status quo may be appropriate, such criticisms are often made without reference to any potential alternatives. Despite these risks there is an incredible value to Regional Council and the public being able to engage in a dialogue and come to some form of consensus on **"what we want our tax system to do for us?"** There is a huge education effort that must accompany any such consultations. One of the benefits that would accompany such consultation is the potential for both citizens and HRM to better understand how the tax system functions, what we want to accomplish through the tax system, what the implications of that system are, and whether there are any viable alternatives to the current system.

2. COUNCIL CONCERNS

During Council's workshop, concerns were raised around

- tax reform,
 - Local Improvement Charges (LICs),
 - diminishing business taxes,
 - perception of high taxes,
 - growth in reserves vs capital spending,
 - Three-year capital budget,
 - Capital Cost Contribution (CCC),
 - needs vs wants,
 - area rates,
 - gas tax rebate and equality of spending,
 - tax subsidy for heritage restoration.
- During Council debates, concerns tend to concentrate on the fairness of the market-based assessment system and the need for reform.

3. CURRENT INITIATIVES

- HRM's Revenue Strategy approved as part of the 2005-2006 business plan, is the key initiative underway to examine municipal taxation. It is based upon the premise that HRM Council comes to some form of consensus on **"what we want our tax system to do for us?"** The Revenue Strategy is intended to provide a very broad review of the taxation system including looking at the relevance of the market value system and by implication the many components of the system established by HRM including the urban, suburban and rural boundaries; the sustainability of area rates for transit service; the deed transfer tax; and, the relationship of the tax system to economic competitiveness and population growth.
- As part of the Revenue Strategy project, in the Fall of 2005 HRM requested additional flexibility in tax powers from the Province including a possible maximum tax and expanded powers on taxation by dwelling units, frontage, acreage and property charges. The Province has suggested further review is required with any recommendations brought forward as part of the Revenue Strategy.
- Council approved an approach and timeline to the Revenue Strategy on September 6th, 2005. That approach saw a series of consultations starting in January, with a Council debate on recommendations in June. Any recommendations would start to be implemented in 2007-2008. Since that time several things have changed. Draft 2 of the Regional Plan is now slated to be discussed in February. In addition, Budget and Business Planning discussions have been pushed past their traditional deadlines. Lastly, HRM is exploring with Service Nova Scotia the possibility that they may join HRM on the Revenue Strategy in some capacity. The addition of the Province to these consultations will be extremely useful for both citizens and HRM. As such, it would be preferable to defer consultations to allow this to happen. The intent would be to launch consultations in the Spring with final Council deliberations in the Fall of 2006. This should still allow for any changes to be phased in starting in 2007-2008. More importantly, it will allow for more thorough public consultations.
- For purposes of the 2006-2007 budget and tax rates, staff are presuming that tax boundaries will not change. There are a number of potential boundary issues across HRM. In most cases these issues need to be resolved in a broader context and may require public input and consultation. Rather than initiate a separate process, changes to tax boundaries should fall out of the upcoming revenue strategy consultations and discussions.

Commercial taxation and competitiveness

- Council has expressed a number of other concerns on taxation and rates. Commercial taxation and competitiveness is an important issue to HRM's long term economic growth. Competitiveness requires a balanced look at both the level of tax that the business community pays and the services that are available to it. Currently the commercial tax

rate is levied as a multiple of 2.55 times the residential tax rate. In addition, commercial businesses also pay the Business Occupancy Tax. Staff are undertaking three key initiatives to help focus better on the commercial area. First, as recommended by the Economic Strategy, staff are benchmarking the commercial tax burden in HRM to other jurisdictions. Benchmarking will look at broad economic measures such as the relationship of tax to GDP but will also review historical trends and sectoral impacts. Consultation and work with the private sector and other government agencies is considered important to the success of this approach. Secondly, staff are researching the cost to provide municipal services to the commercial sector. Lastly, staff are looking to prepare a RFP to help analyse the economic impact of commercial taxation. Results from this initiative are targeted for the Fall of 2006.

Business Occupancy Tax (BOT)

- The phase-out of the BOT offers the opportunity to create a more competitive tax system. There will be a need to offset the revenue losses from the BOT elimination, starting in the 2006-2007 budget. Some of this loss can be offset due to cost savings from the BOT elimination. As in most jurisdictions that have eliminated the BOT, however, a higher commercial tax rate can be used to offset the lost BOT revenues. In this fashion, the total taxes levied on the commercial sector would stay the same, although some of that tax burden would be redistributed amongst commercial sectors. In addition, the Federal Government does not currently pay the BOT. If it does pay any higher commercial tax rates (due to the BOT phase-out) this should provide additional funds that could offset the overall commercial tax burden. Staff are awaiting additional data from the Province on the phase-out and expect to return with recommendations early in 2006 as part of the budget process.

Local improvement charges (LICs)

- Local improvement charges are also an important element of HRM's revenue system. LICs are a charge levied on a homeowner to provide for the cost of acquiring hard infrastructure (such as sewers, streets or sidewalks). While property tax generally spreads the cost of services out over the entire tax base, LICs often require the abutting property to pay for such first-time items such as street upgrades (from one type of surface to another such as gravel to paving) or a new sidewalk. This shifts the burden of acquiring that infrastructure onto those more likely to request or use it. LICs are often accompanied by a neighbourhood vote before the infrastructure is approved by Council. LICs can be levied in many ways including frontage or lot size but in recent years district area rates have been used to raise LIC funds. Staff have not undertaken a systematic review of LICs since the last round of tax structure reform in 2002-2003. A review of LICs to ensure they encourage long-term sustainable growth in the municipality is intended following the dialogue that occurs from the Revenue Strategy's community consultations.

Capital Cost Contribution (CCC)

- The Capital Cost Contribution (CCC) has been identified in the Regional Plan as an area for review. Currently HRM has issued a RFP to review the current CCC and to look at means of expanding and improving the system.

Tax Burden

- Council expressed concerns over the perceptions of high taxes. Staff is collecting tax and service data and other information for the benchmarking of taxes. For example, HRM participated in a benchmarking exercise on taxation levels led by the City of Edmonton (see attachment). This data shows that on average the tax burden for a single unit home ranks 5th lowest out of 24 major cities. This work is part of staff's ongoing work and needs to be incorporated into HRM's communication messages.

Heritage Rebates

- Heritage Rebates and the potential use of tax incentives to encourage historic preservation is being considered as part of the Heritage Function Plan under the Regional Plan.

3. RECOMMENDATIONS

- Working with the Province of Nova Scotia, proceed with taxation consultations in the Spring of 2006, returning to Council in the Fall of 2006 in advance of the 2007-2008 budget deliberations.
- Consider any broad revisions to tax boundaries as part of the overall review of the tax system. Technical changes to tax boundaries (as required) for 2006-2007 could be considered in the 2006-2007 budget.
- Continue with commercial taxation competitiveness analysis and benchmarking and return to Council in the Fall of 2006 with the results and any recommendations.
- Recommend an approach to the elimination of the BOT, starting with the 2006-2007 budget.
- Examine LICs and CCC as part of the Revenue Strategy and make any appropriate recommendations to Council in the Fall of 2006.
- Incorporate tax burden information into the 2006-2007 budget debate and future Council deliberations.

COUNCIL STRATEGIC TOPIC: TAXATION

ISSUE	OPTIONS	IMPLICATIONS
<p>Create an appropriate balance between reliance on the “market-based” assessment system and other forms of taxation and charges.</p> <p>Need to encourage growth and development.</p> <p><u>INITIATIVES</u></p> <p>A) Tax Reform (Revenue Strategy)</p>	<p>Undertake community consultations starting in the Spring or Fall of 2006` focussing on a broad review of the tax system and what we want our tax system to do for us?</p> <p>Discussion will also explore how to best encourage growth.</p> <p>Report to Council on possible tax options and approaches. Postpone community consultations until Council has narrowed the list of possible tax and revenue alternatives.</p>	<ol style="list-style-type: none"> 1. A specific tax system needs to be - designed around (1) the principles of a well-designed tax system, (2) the intended purpose of the tax system, (3) any specific behaviours that Council wishes to encourage or discourage. 2. Tax implications may range from relatively minor to widespread, depending on the final recommendations. The more extensive the change the more dramatic will be the impacts. 3. Legislative changes may be required, (hence provincial approval) and may need to be phased in over a period of time. 4. There is a tremendous value to achieving a consensus with the community over what the tax system is intended to accomplish.

<p>Taxes affect business decisions to invest and innovate, and people's decisions on where they live and work. While taxes pay for public services, taxes that are too high or levied inefficiently, affect economic growth and, eventually, those same public services. Current provincial and local tax and regulatory policies are working against export-oriented growth drivers in HRM's economy.</p>	<p>1. Benchmarking of HRM Commercial taxes is underway from three perspectives: (i) Broad GDP measures, (ii) Historical Trends, (iii) Sectoral comparisons to other cities.</p> <p>2. Costing is underway to determine cost to provide services to business community.</p> <p>3. RFP is being developed to help determine impact of commercial taxation upon the HRM economy.</p>	<p>1. Recommend the best mix of tax changes to meet those targets considering those based on (1) reducing the overall commercial tax burden through changes in the tax rates or the commercial tax multiplier; (2) introducing new classes of commercial assessment or different types of commercial taxes; and (3) adding additional features to the tax system considering incentives, graduated rates and tax zones.</p>
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<p>Provincial Government is phasing out Business Occupancy Tax (BOT)</p>	<ol style="list-style-type: none"> 1. HRM is developing transition options as the BOT is eliminated. Options include increasing the commercial tax rate to recoup the BOT loss, hence the total commercial property tax levy would stay the same as if the BOT were not eliminated. Another option is to increase the residential tax rate to offset the phase-out of the BOT. 2. There may be a financial benefit to HRM from the Federal Government paying the higher commercial tax rate. (Currently the Federal Government does not pay BOT). These funds could be used to help lower the commercial tax burden. 	<ol style="list-style-type: none"> 1. If BOT revenues are recouped through the commercial tax rate, the long-term impact will be to alter the tax burden on specific sectors on the economy. 2. If additional grants in lieu are used to offset the commercial tax burden, that would be seen as returning the benefits of the BOT elimination to the commercial sector.
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