Revenue Neutral Tax Explanation

Why is Revenue Neutral Important?

The City's revenue neutral tax system is consistent with certain principles within the *Municipal Government Act* (MGA) and Alberta Municipal Affairs (AMA) guidance. This ensures that:

- Total tax revenues do not change automatically with assessment changes year over year, which creates less volatility; and
- Any tax revenue change brought forward by The City is communicated separately through the budgetary process.

Conversely, in a rate-driven tax system, assessment value increases or decreases directly impact the amount collected through property taxes.[1] In this system, the assessment is not only responsible for distributing property taxes but controls the magnitude of property taxes as well.[2] This system fails to meet the test of open and transparent property taxation.[3]

The revenue neutral tax system makes certain that the assessment process remains a distinct and separate process from the budgetary process. Revenue neutral ensures that no new taxes will be collected due to the annual reassessment process.

Revenue Neutral and the Municipal Property Tax Rate Calculation

Once all properties are reassessed and the assessment roll is finalized, a revenue neutral tax rate is determined.

Municipal Revenue Neutral Tax Rate = <u>Last year's revenue required by The City of Calgary from property tax</u>
This year's total assessment

When property values go up, the revenue neutral tax rate decreases and when property values go down, the rate goes up.

Council sets the budget to ensure that The City collects only what it needs to meet its financial commitments: the operating and capital costs of serving a community of more than 1 million people. To get the amount of revenues required from property taxes, The City takes the overall expenditure and subtracts all other sources of revenue such as license fees, user fees and provincial grants. The remainder is the amount of money the municipality needs to raise through property taxes in order to provide services for the year. This revenue requirement is then used to calculate the tax rate. Any changes in the revenue requirement is applied to the revenue neutral tax rate. Or simply, the tax rate calculation is as follows:

Municipal Tax Rate = <u>This year's total revenue required by The City of Calgary from property tax</u>
This year's total assessment

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[1] See International Association of Assessing Officers. "Standard on Property Tax Policy." *International Association of Assessing Officers*, 2020: s. 6.2. https://www.iaao.org/media/standards/Standard_on_Property_Tax_Policy.pdf.
See also International Association of Assessing Officers. "Standard on Property Tax Policy." *International Association of Assessing Officers*, 2010: s. 5.2.1.
[2] Ibid.
[3] Ibid.

The tax rate is then applied to each individual property assessment using the following formula:

Property Assessment ($) x Municipal Tax Rate = Municipal Taxes Payable

Because of revenue neutral, taxpayers are assured that The City does not:
- take advantage of rising market values to collect more tax than it needs, or
- calculate property taxes based on the increase or decrease in market value from one year to the next.

In surveying other jurisdictions across Alberta and Canada, all who have responded have confirmed the use of the revenue neutral system:

Municipality	Taxation Method
Calgary	Revenue Neutral
Camorse	Revenue Neutral
Edmonton	Revenue Neutral
Lethbridge	Revenue Neutral
Red Deer	Revenue Neutral
Grande Prairie	Revenue Neutral
St. Albert	Revenue Neutral
Strathcona County	Revenue Neutral
Medicine Hat	Revenue Neutral
Airdrie	Revenue Neutral
RM Wood Buffalo	Revenue Neutral
British Columbia - Province Wide	Revenue Neutral
City of Winnipeg	Revenue Neutral
City of Saskatoon	Revenue Neutral
Ontario (MPAC) - Province Wide	Revenue Neutral

Though the revenue neutral system is not required, many jurisdictions choose to use it as it provides confidence in the integrity and transparency of the property assessment and tax system.

Within Calgary, the revenue neutral calculation takes place on an annual basis with the finalization of the assessment roll in December. Should The City's property tax budgetary requirements change, the tax rate is further adjusted, typically in spring of each year, to bring in the amount of revenue needed as directed by Council when the property tax bylaw is approved.

The revenue neutral model means that, excluding Council decisions to change the tax rate, for every additional tax dollar levied to one property, there is a tax dollar reduction in another. Assessment acts only as a mechanism to annually distribute taxes to each taxpayer in an equitable manner. The assessment process does not determine the overall level of taxation, the Council approved budget does. This is revenue neutrality in action.

<u>How does this work for the average residential homeowner?</u>

The City begins by revaluing every property in The City based on real estate market transactions that have occurred. A typical assessment value change for residential properties for the whole city (the "aggregate mean") is then determined. If the homeowner's assessment changes by the same amount as the typical change (the aggregate mean), the amount they pay in property taxes will likely be unchanged as a result of the reassessment. If their value change is above the typical, they will see a tax increase as a result of the reassessment and if it is below, they will see a tax decrease.

The above example assumes that The City's revenue required from property taxes stays unchanged from one year to the next based on Council's approved budget.

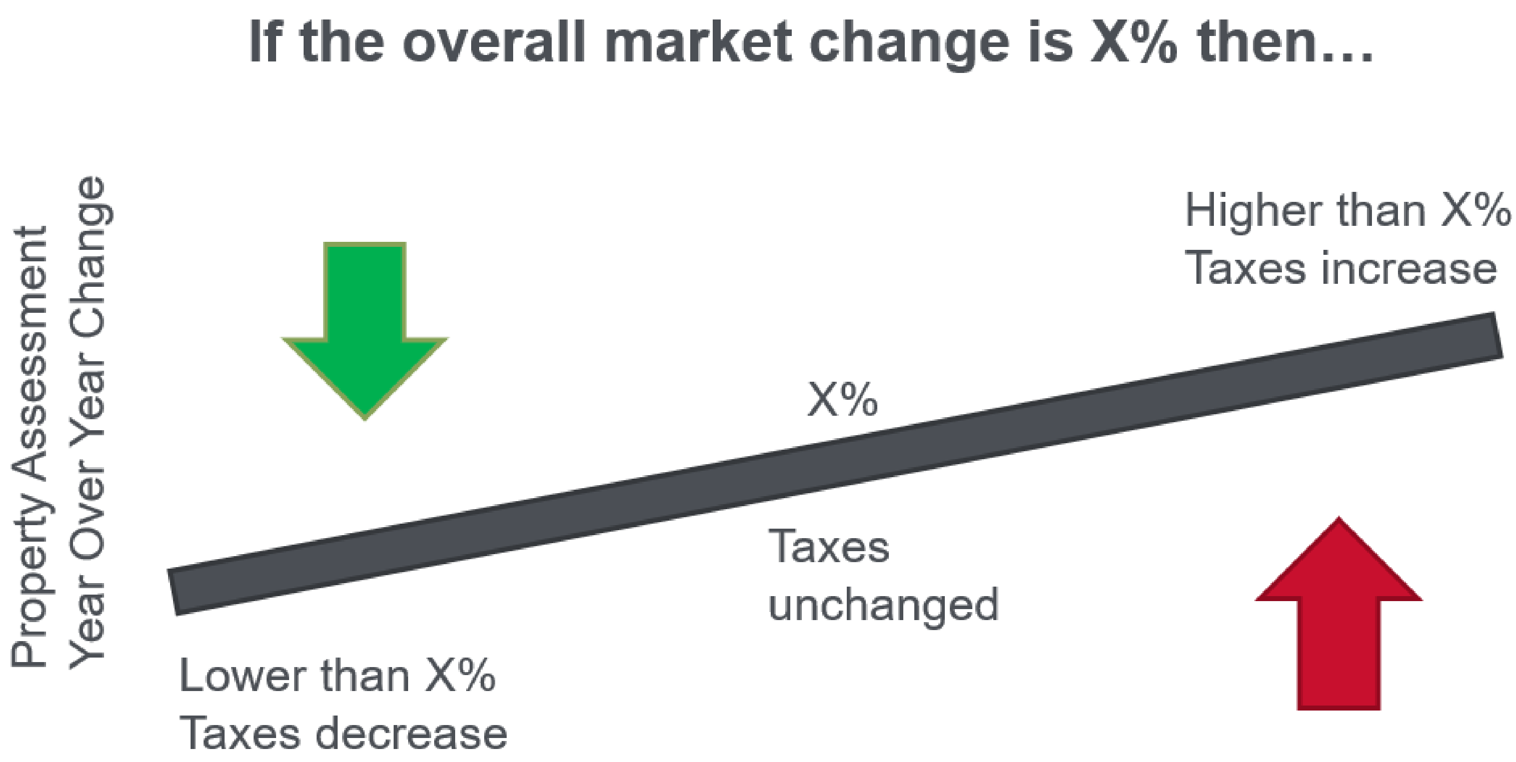
Table 2 shows an example of reassessment impacts on property taxes using revenue neutral, while Table 3 shows (in contrast) an example of reassessment impacts on property taxes in a rate-driven tax system.

Table 4 shows a year to year comparison between using the historical actual tax rate and a hypothetical example of a fixed tax rate. The actual tax rates were determined using the revenue neutral process and factoring in budget changes as directed by Council. The fixed tax rate represents a rate driven system over the last 20 years where the tax rate is hypothetically held constant and changes in property tax revenues are based solely on property market value changes. It is important to note that in this example when the tax rate was frozen at the 2000 levels,[4] the overall tax revenue collected was higher in the years where assessment values increased and lower in years when assessment values drop. As a result of the chosen tax rate it is also possible, that the rate driven system would result in higher tax revenues collected than what was required by the municipality. In this illustration, if The City had maintained the 2000 tax rates for the last 20 years, the total tax levy would have been almost $8 billion dollars more despite the recent downturn. The property tax volatility would have been significantly higher for both The City and taxpayers which would have included a 47 per cent property tax increase in 2007 followed by a 30 per cent increase in 2008.

The revenue neutral system ensures that a municipality can meet its budgetary requirements each year and does not directly tie the volatility of the real estate market to the revenues collected. In this way, property owners are ensured of a fair and transparent system and that the municipality only collects what it needs each year.

[4] It is noteworthy that the year 2000 marked the second year of the use of Market Value Assessment, as well as the first year of the annual reassessment cycle.

Table 1. Revenue Neutral: Visual Explanation



* Table 1 visual sourced from Assessment's COVID-19 Webpage: www.calgary.ca/pda/assessment/preparing-2021-property-assessments-during-covid-19.html

Table 2: How Revenue Neutral Works – A Typical Cycle

The figures below are hypothetical and are intended for illustration purposes.

Year 1 Tax Rate Calculation Budget ÷ Assessment Base = Tax Rate $8,000 ÷ $800,000 = 0.01	House 1	House 2	House 3	
Assessed Value x Tax Rate = Year 1 Taxes Payable	$150,000 x 0.010000 = $1,500	$250,000 x 0.010000 = $2,500	$400,000 x 0.010000 = $4,000	= $800,000 Assessment Base = $8,000 Budget Requirement
Year 2 Reassessment Assessment Change (per cent)	$165,000 +10 per cent	$275,000 +10 per cent	$440,000 +10 per cent	= $880,000 Total = +10 per cent overall increase
Year 2 Revenue Neutral Tax Calculation with No Budget Change Budget ÷ Assessment Base = Tax Rate $8,000 ÷ $880,000 = 0.009091				
Assessed Value x Tax Rate = Year 2 Taxes Payable Year over Year Tax Change (per cent)	$165,000 x 0.009091 = $1,500 0 per cent	$275,000 x 0.009091 = $2,500 0 per cent	$440,000 x 0.009091 = $4,000 0 per cent	= $880,000 Assessment Base = $8,000 Budget Requirement
Year 3 Reassessment Assessment Change (per cent)	$165,000 0 per cent	$269,500 -2 per cent	$418,000 -5 per cent	= $852,500 Total = -3.125 per cent overall increase
Year 3 Revenue Neutral Tax Calculation with No Budget Change Budget ÷ Assessment Base = Tax Rate $8,000 ÷ $852,500 = 0.009384				
Assessed Value x Tax Rate = Year 3 Taxes Payable Year over Year Tax Change (per cent)	$165,000 x 0.009384 = $1,548 +3 per cent	$269,500 x 0.009384 = $2,529 +1 per cent	$418,000 x 0.009384 = $3,922 -2 per cent	= $852,500 Assessment Base = $8,000 Budget Requirement

Table 3: Rate-Driven Tax Example

The figures below are hypothetical and intended for illustration purposes only.

Year 1 Tax Rate Calculation Budget ÷ Assessment Base = Tax Rate $8,000 ÷ $800,000 = 0.01	House 1	House 2	House 3	
Assessed Value x Tax Rate = Year 1 Taxes Payable	$150,000 x 0.01 = $1,500	$250,000 x 0.01 = $2,500	$400,000 x 0.01 = $4,000	= $800,000 Assessment Base = $8,000 Property Tax Revenue
Year 2 Reassessment Assessment Change (per cent)	$165,000 +10 per cent	$275,000 +10 per cent	$440,000 +10 per cent	= $880,000 Total = +10 per cent overall increase
Assessed Value x Tax Rate = Year 2 Taxes Payable Year over Year Tax Change (per cent)	$165,000 x 0.01 = $1,650 +10 per cent	$275,000 x 0.01 = $2,750 +10 per cent	$440,000 x 0.01 = $4,400 +10 per cent	= $880,000 Assessment Base = $8,800 Property Tax Revenue +10 per cent
Year 3 Reassessment Assessment Change (per cent)	$165,000 0 per cent	$269,500 -2 per cent	$418,000 -5 per cent	= $852,500 Total = -3.125 per cent overall increase
Assessed Value x Tax Rate = Year 3 Taxes Payable Year over Year Tax Change (per cent)	$165,000 x 0.01 = $1,650 0 per cent	$269,500 x 0.01 = $2,529 -2 per cent	$418,000 x 0.01 = $3,922 -5 per cent	= $852,500 Assessment Base = $8,525 Property Tax Revenue -3.125 per cent

Table 4: Comparison of the Revenue Neutral System and Rate Driven System Over 20 Years