The City of Calgary

Tax Distribution Scoping Report

Financial Task Force Implementation Team
Chief Financial Officer's Department
2021 December 07

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1. Introduction and Purpose

In July 2020, the Financial Task Force recommended (see Appendix 1) that The City contract an independent expert to consult with The City on several taxation policy-related matters including providing an acceptable and reasonable split of property tax responsibility between residential and non-residential taxpayers. In its response to the recommendation, Administration committed to “refine the scope of a potential analysis and review the feasibility of proceeding with an independent expert in the development of municipal tax policy and recommend a delivery date that considers resource constraints if appropriate.”

The purpose of this scoping report is three-fold. First, for the report recommends a reliance on City of Calgary analysis rather than additional expenditures on an external consultant. External members of an FTF Implementation Steering Committee have agreed to support and review the analysis. Second, three different approaches to addressing the split between residential and non-residential taxpayers are introduced; these three approaches are the mainstream practices in Canadian jurisdictions. Finally, next steps in the process including a stakeholder engagement plan and data development strategy are presented.

2. Is an independent expert required?

The questions regarding the appropriate distribution of the property tax between classes raised by the Financial Task Force are common in municipalities across Canada and there is substantial pre-existing literature on the subject, including two major reports from Vancouver,[1] one from Nova Scotia,[2] one from St. John, New Brunswick[3] and another from Saskatoon.[4] While the field is evolving, there are two leading academic experts in municipal finance that concentrate on property tax in Canada: Enid Slack and Harry Kitchen. Access to their expertise is available in the reports from Vancouver (Slack), Nova Scotia (Kitchen and Slack), and St. John, New Brunswick (Kitchen and Slack).

Proceeding with a Calgary-specific study holds the potential to find an answer to the long-standing question on the appropriate distribution of taxes between different property classes. Those expectations may need to be tempered, however, by the results from other similar investigations mentioned above, which were authored or co-coauthored by Canada’s leading experts on municipal tax policy. For example, the report commissioned by the Government of Nova Scotia concluded as follows without making a recommendation,

> Unfortunately, there is no single means of determining the appropriate tax rate ratio for business relative to residential properties. Stakeholders offered some ideas of an

[1] Stanley Hamilton, Peter Adams and Enid Slack, *City of Vancouver Property Tax Policy Review Commission: Final Report* (City of Vancouver, 2007) https://vancouver.ca/taxcommission/assets/pdf/2007-commission-report.pdf and Stanley Hamilton, Peter Adams and Enid Slack, *Property Tax Policy Review Commission: 2014 Report* (City of Vancouver, 2014) https://vancouver.ca/taxcommission/assets/pdf/report-property-tax-policy-reivew-2014-colour.pdf

[2] Harry Kitchen and Enid Slack, *Municipal Property Taxation in Nova Scotia* (Association of Municipal Administrators Nova Scotia, 2014) https://www.amans.ca/other-resouces/79-municipal-property-taxation-final-report/file.html.

[3] Harry Kitchen and Enid Slack, *Municipal Property Tax Issues in the City of Saint John* (City of Saint John, 2017) https://saintjohn.ca/sites/default/files/2021-03/10.%20Kitchen%20and%20Slack%20Final%20Report%20-%20August%202017.pdf

[4] Mike Jordan, *Business Property Taxation by Cities: What We Know, What We Don’t, and What We Should* (City of Saskatoon, 2017) https://www.saskatoon.ca/sites/default/files/documents/asset-financial-management/assessment-taxation/business_property_taxation_by_cities_march_2017.pdf

> appropriate ratio but provided no justification for their suggested ratio. Nor were we able to obtain any empirical evidence of business leaving the province solely because of property taxes. Hence, we are not in a position to make a recommendation on the appropriate ratio of commercial to residential tax rates, but we are suggesting that municipalities monitor the impact of commercial property taxes on their ability to attract and retain business.[5]

Similarly, the conclusion of the Vancouver Tax Commission, in their 2007 report, was:

> We have not been able to identify a simple indicator of an appropriate tax share. Instead, the choice of tax share is a judgment call – one that needs to weigh the strength of concern with the current tax share against the likely consequences of change.[6]

The Vancouver Commission ultimately recommended a tax share of 48% from a starting point of 55% for the non-residential taxpayers.[7] A subsequent report by the Commission in 2014, when the tax share was 43.2%, concluded that, given the set of circumstances in Vancouver at the time, there should be no additional changes to the tax share.[8] The share of property taxes paid by non-residential taxpayers in Vancouver for 2021 was 42.9%. In Vancouver, the determination of tax share features in Vancouver's tax rate-setting annually.[9]

Given the amount of study on this topic by municipal tax experts and the failure thus far to arrive at a simple answer, the value of spending on an independent expert would primarily be the independence of the recommendation compared to a recommendation from Administration.

Having reviewed the relevant literature, Administration does not recommend proceeding with a study by an independent expert. Instead, Administration recommends internal analysis culminating in a taxation policy that responds to the issues raised by the Financial Task Force. Administration will complete work on the policy for Council approval no later than the end of Q2 2022.

The reasons for the recommendation are:

(1) Administration is confident that it can complete the work in 2022 and believes that Council will have adequate, high-quality information for decision-making without the added cost of hiring an independent expert;
(2) Calgary already has strong subject matter competency and Administrative analysis is an opportunity to further enhance that competency;
(3) Through the SAVE program, Administration has made a commitment to hiring fewer consultants;
(4) Administration has already benefitted from outside advice from the Real Estate Working Group (see section Real Estate Working Group Section) and thwew will be an opportunity to benefit from the input from independent parties through additional stakeholder engagement.

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[5] Kitchen and Slack, *Nova Scotia, p. 69.*
[6] Hamilton, Adams and Slack. *Vancouver 2007*, p. 53.
[7] The City of Vancouver, *Report by the Director of Finance to Vancouver City Council on the 2021 Property Taxation: Distribution of Property Tax Levy* (The City of Vancouver, 2021), p. 4. https://council.vancouver.ca/20210427/documents/r4.pdf.
[8] City of Vancouver, *2014 Tax Commission),* p. 27.
[9] See City of Vancouver, *Distribution of Property Tax Levy* at 8.

If, however, Council believes that an independent view is still worthwhile, Administration has included Appendix 2, with further considerations related to hiring an independent expert. Council could direct Administration to proceed with the work via an independent expert; Administration has made the necessary preparations to follow through on that direction if required and would pursue a commission model similar Vancouver's if that was Council's desire.

3. Overview of Administration's Plan to Address Recommendation 19 – Distribute Tax Responsibility Appropriately

As part of the response to the Financial Task Force Recommendations, Administration committed to bringing a Taxation Policy to Council. The Taxation Policy will be Council's opportunity to set a path forward on addressing property tax-related issues. Table 1 below outlines the components of the recommendation and the timing of Executive Committee reports to address them.

Key Components of Recommendation 19	Timeframe
• Determine the objectives that would inform the determination of the acceptable and reasonable split.	December 2021
• Explore the viability of pegging mill rates and options (if any) that would work for the Calgary context.	Introduced December 2021, Taxation Policy
• Use the results to address the risk that one taxpayer category may be overpaying for services.	Taxation Policy
• Incorporate the outcomes of recommendation #12 that targets making subclasses usable.	Taxation Policy
• The extent to which it makes sense to determine tax rate thresholds that once breached would trigger the need for mill rate stabilization using an existing or a new reserve.	Taxation Policy
• The range of fiscal tools, including reserves like the fiscal stability reserve, to minimize tax volatility while also maintaining a stable fiscal position.	Taxation Policy
• Use the results to anchor future tax redistribution decisions.	Tax Rate Setting in 2022 and Beyond

Table 1 Proposed Next Steps to Address Financial Task Force Recommendation #19

3.1. Efforts through the Real Estate Working Group

In addition to the efforts of the Financial Task Force Implementation team, the Real Estate Working Group was also asked to give advice on Recommendation 19. The Real Estate Working Group was formed in response to a Motion Arising from Council's approval of the Financial Task Force Recommendations – Implementation Approach and Resources (C2020-0815), to provide advice to the Chief Financial Officer to Recommendation 19 (among others). The Real Estate Working Group is expected to present final findings on Recommendation 19 to the Executive Committee in December 2021. Administration's detailed response to the findings and advice from the Real Estate Working Group is available in Appendix 3. In summary, Administration plans to take the advice of the Real Estate Working Group into consideration as the taxation policy is developed.

4. Scoping Report Background – Tax System Basics

Before diving deeper into the different tax distribution approaches available to The City, it is important that the basics of the tax system are well understood.

In Alberta, budgeting, assessment and taxation are connected in the development of the tax rate. The calculation of the tax rate is detailed in section 355 of the *Municipal Government Act*:

> 355 A tax rate is calculated by dividing the amount of revenue required by the total assessment of all property on which that tax rate is to be imposed.

The equation is presented below for clarity:

$$Tax\ Rate\ = \frac{City\ Revenue\ Requirement}{Total\ Assessed\ Value\ of\ All\ Taxable\ Properties}$$

Equation 1 The calculation of the tax rate as set out in the *Municipal Government Act*.

In short: (1) Council sets the amount of money required from property taxes to fund The City through the service planning and budgeting process usually in the November prior to the budget year; (2) assessments, which are sent in January of the budget year, determine both the total value of all properties within a class and the assessed amount on which the tax is imposed for each taxpayer; (3) the tax rate is typically set in April via the property bylaw, using the amounts from (1) and (2); and (4) the tax rate is applied to each assessment in a tax bill which is typically mailed in mid-May and due at the end of June.

This methodology is widely called the budget-based approach to tax rate setting and The City of Calgary refers to this as the revenue neutral approach because market value changes in assessments do not impact the total amount of revenue collected by The City. Using this method means that the tax rate floats. To achieve the same revenue, the tax rate goes lower when property assessments increase, and it goes higher when property assessments decrease.

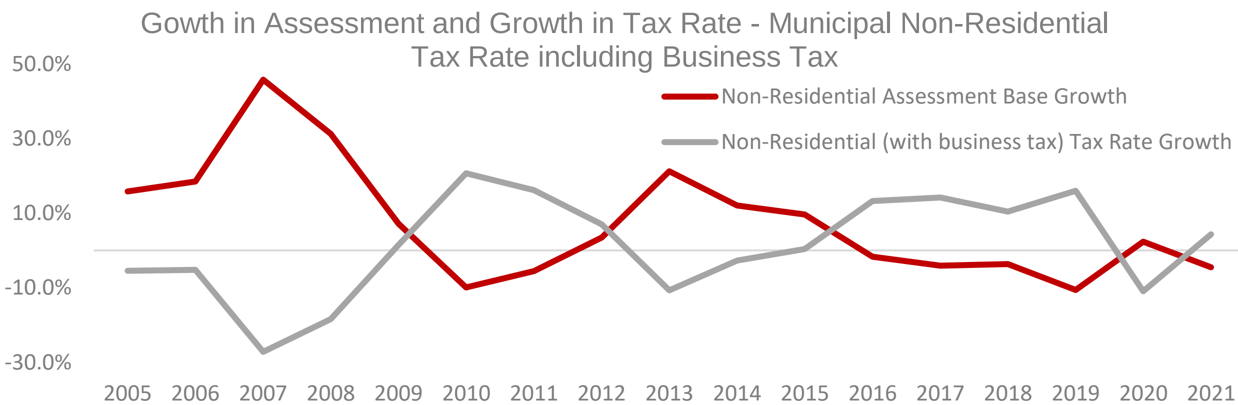

Figure 1 The negatively proportional relationship between assessed values and municipal property tax rates using the Budget Based Approach. Note: Calgary collected a business tax until 2019. To isolate the relationship between the assessment base and tax rate, the historical tax rates have been adjusted to reflect what the tax rate would have been if the amount collected by the business tax were raised through the non-residential property tax.

The relationship between the assessed value of non-residential properties and the non-residential municipal property tax rate is shown below in Figure 1. In Calgary, there was a swift rise in non-residential property assessments in 2007 and 2008 which led to a rapid decrease in the tax rate. This was followed by a rapid decline in non-residential property assessments in2010 and 2011 which led to large increases in the tax rate.

Lower assessments from 2016 to 2019 led to increases in the non-residential property tax rate until Council took additional action, including lowering the property tax budget in the summer of 2019, and lowering the share of property taxes paid by non-residential properties 2020.

An alternative approach is the rate-based approach. In the rate-based approach, a static tax rate is applied to the assessed value of properties. This approach has led to “tax revolts” in some jurisdictions when there were rapid increases in the market value of properties that led to windfall revenues for municipalities.[10] It would also mean either entering into a deficit position or significant cuts to City budgets when the economy declines.

The comparison chart below in Figure 2 demonstrates why the rate-based approach has been unsuccessful in other jurisdictions. The City of Calgary has experienced some property tax levy variability under the budget-based approach but the variability would have been much more significant if we had applied the rate-based approach. An important takeaway from the analysis is that substantial year-over-year shifts in assessed values in Calgary would limit the usefulness of the rate-based approach.

When the increases in property market values are rapid, like in 2007 to 2008 for Calgary, there could be very large increases in the amount of property tax levied to the point that citizens would urge for changes to the tax system. Conversely, when property values decline, like in 2011 for Calgary, the resulting decline in taxes levied (~11%) would put extreme pressure on City services. To be practical, this type of system would require smoothing in either assessments or property tax, though even a 5-year averaging of assessments would have resulted in significant (i.e. greater than 20% increases) in boom periods.[11]

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[10]Assessing Officers, *Standard on Property Tax Policy,* p. 16. The most famous property tax revolt was in California in 1978. The tax revolt led to Proposition 13 an amendment to the California constitution which capped assessment increases to a maximum of two percent until a property is purchased, at which point it is reassessed at its purchase price, and capped the property tax rate at one percent. Although the policy, which was imposed by the State of California after a statewide referendum, was successful in limiting property tax volatility it had a very negative effects on the state of municipal finances in California. Initiatives like Proposition 13 spread to other states in the United States soon after. For more on this see Mac Taylor, *Common Claims About Proposition 13* (Legislative Analysts Office, 2016). Accessed at https://lao.ca.gov/reports/2016/3497/common-claims-prop13-091916.pdf on July 25, 2021.

[11] The City of Calgary is proceeding with a study of assessment smoothing with the results to be reported in 2022. Property tax experts do not recommend capping assessments because they make the administration of the system more complex, are confusing to taxpayers, and tend to benefit those that accruing additional wealth at the expense of those whose wealth is remaining static. See Harry Kitchen, Melville McMillan and Anwar Shah, *Local Public Finance and Economics: An International Perspective* (Cham: Palgrave MacMillan, 2019), p. 296. Enid Slack and Richard Bird, *How To Reform The Property Tax: Lessons From Around The World*, Institute for Municipal Finance and Governance, IMFG Papers on Municipal Finance and Governance, 2015: p.22-23.

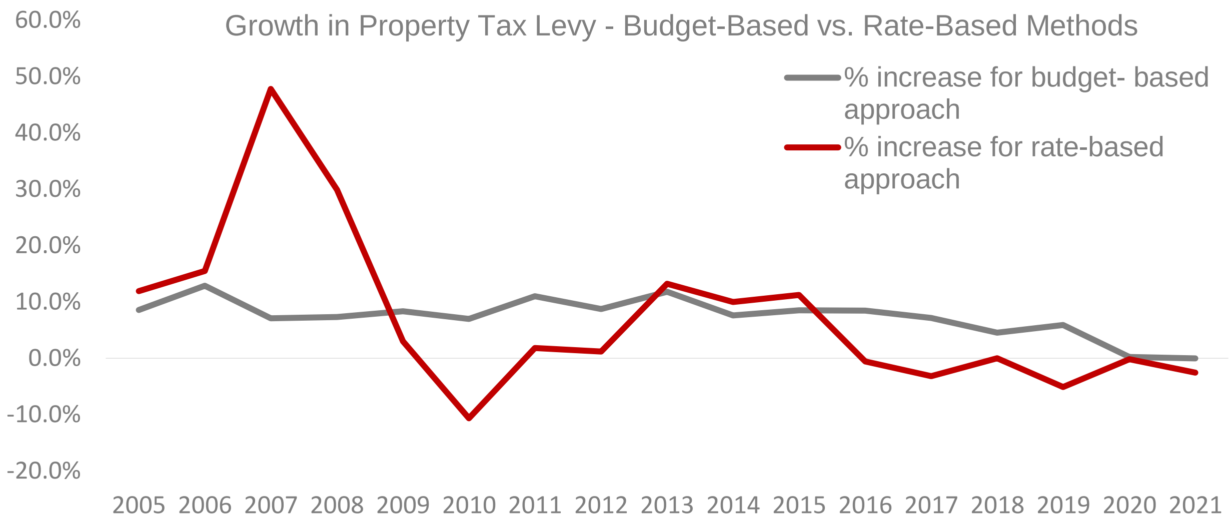

Figure 2 The comparison between the budget-based and rate-based approaches to property tax rate setting. Using a static tax rate would result in very large swings in City revenues, whereas the budget-based approach provides a steadier rate of growth in the property tax levy.

The result of the budget-based approach to tax rate setting is a steady revenue source based on a volatile tax base. That it is why it is the preferred approach of assessment professionals,[12] some property tax experts[13] and a common practice among Canadian municipalities.

4.1. Sources of Tax Volatility

While a floating rate helps to control the overall increase in the tax levy and reduce volatility in City revenues, it can lead to unexpected volatility for some taxpayers. This volatility typically has three sources:

(1) Council directed changes to the property tax levy. Council directed changes to the property tax levy rarely result in large scale changes. The range of impact on property taxpayers due solely to Council directed changes typically ranges from -3% to 8%.

(2) Tax shifts due to differential market changes within an assessment class. This type of change is exemplified in the downtown tax shift that occurred in Calgary from 2016 until the present. It was caused by the dramatic decreases in the market value of downtown office properties accompanied by relatively stable market values for other types of property. The range of impact in any particular year due to this type of change is -15% to 15%. It is important to note that these shifts can result in substantial changes in property taxes even when assessments remain unchanged and have the potential to impact a large number of properties. It is more likely that shifts will occur where the are several types of properties within a class and values are highly

[12] International Association of Assessing Officers, *Standard on Property Tax Policy*, (International Association of Assessing Officers, 2020) p. 16. Accessed at https://www.iaao.org/media/standards/Standard_on_Property_Tax_Policy.pdf on April 2, 2021.
[13] Referred to as the “rollback rate” in Keith Ihlandfeldt, *The Property Tax Is A Bad Tax, But It Need Not Be*, “Cityscape: A Journal of Policy Development and Research” 15, No.1 (2013): p.222. Accessed at https://coss.fsu.edu/dmc/wp-content/uploads/sites/8/2020/09/03.2013-The-Property-Tax-is-a-Bad-Tax-but-It-Need-Not-Be.pdf on October 13, 2021.

concentrated in one of those classes. This means that significant tax shifts are more likely in the non-residential class which has a highly diverse inventory than the residential class.

(3) Market value assessment volatility. This type volatility arises from the changes in property markets which are then reflected in market value assessments. These types of changes can result in very large property tax changes in a short period of time but typically affect fewer properties than the other types of volatility. Changes in market value can mean tax changes ranging from -30% to more than 100%.

4.2. Tax Revenue Share

The tax revenue share is the proportion of tax responsibility borne by each class. The tax revenue share carried by non-residential property taxpayers (including business tax) has been declining for some time. The decline is due to two factors: (1) a freeze on business tax, which was continued as business tax revenues were consolidated into the non-residential property tax; (2) a decision by Council 2019 to reduce the tax responsibility of non-residential property tax payers from 53% to 48%. The chart below in Figure 3 shows that non-residential property taxpayers paid 60% of property taxes in 2005 and now pays 48%.

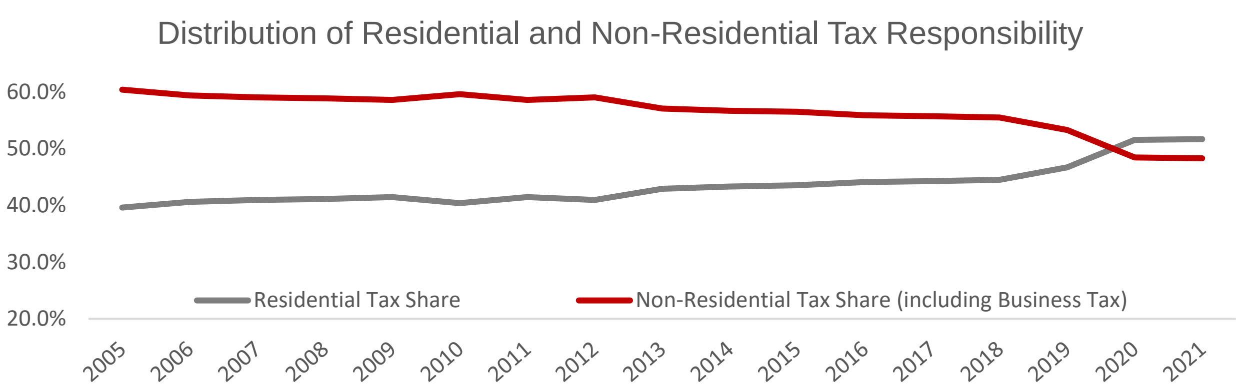

Figure 3 This chart shows the decline in the share of property taxes paid by non-residential property taxpayers since 2005. The decline was accelerated by the property tax share decision by Council for the 2020 budget and remained at 48% this year.

4.3. Tax Rate Ratios

The tax rate ratio is determined by dividing the tax rate of non-residential property taxpayers to residential property taxpayers. In terms of tax dollars, the ratio tells you how much a non-residential property taxpayer pays per one dollar in assessment compared to residential property taxpayer. The City's municipal property tax rate ratio in 2021 was 3.42:1 and so for every dollar of assessment, a non-residential property taxpayer pays 3.42 times more than a residential property taxpayer.

The Calgary Chamber of Commerce has suggested a tax rate ratio of 2.8:1. The Government of Alberta has set a maximum tax rate ratio of 5.0:1. The tax rate ratio has declined for similar reasons as property tax share but that decline is less smooth because the relative performance of each assessment has an impact on the ratio. For example, the tax rate ratio increases in 2011 and 2017-2019 are due to the relatively poor performance of the non-residential property market compared to the residential property market. The ratio would have continued to increase had Council not taken action by reducing the non-residential tax share for 2020.

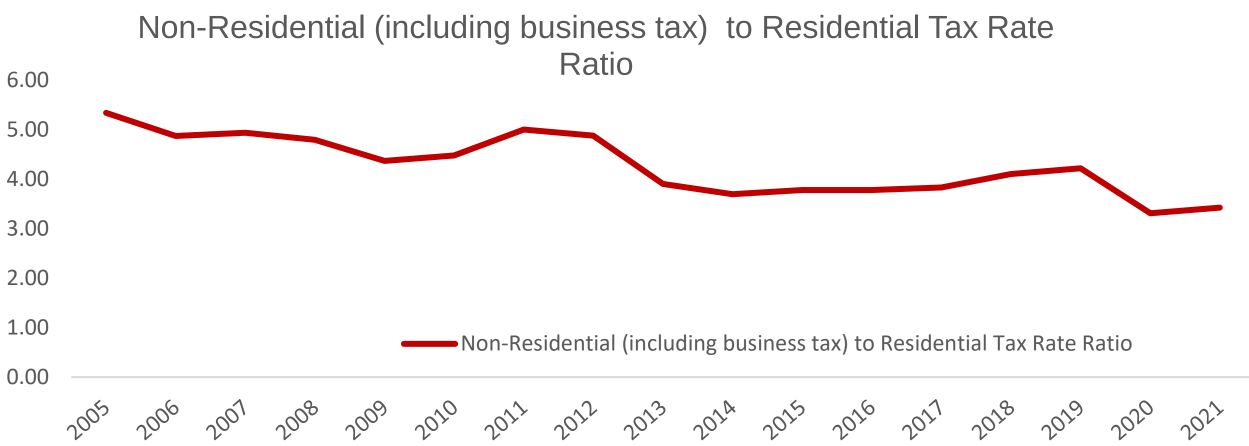

Figure 4 The non-residential to residential tax rate ratio shows that the ratio has been declining since 2005 due to various Council decisions.

5. Principles of Taxation Policy

As detailed above, Administration is currently preparing a Taxation Policy for Council's consideration by the end of Q2 2022. The policy will be based on the enduring principles of taxation discussed below. The application of those principles to the outstanding questions raised by the Financial Task Force along with historical, regional and national context will inform the composition of the policy.

It is generally accepted that the following principles form the basis of an effective framework for evaluating tax systems and tax reforms:[14]

Fairness: Ability to Pay

Fairness in the property tax system is based primarily on the ability to pay and the ability to pay is based on the concepts of horizontal and vertical equity. Horizontal equity means that people in similar circumstances pay a similar amount of tax. Vertical equity means that people in differing circumstances with different abilities to pay, pay a different amount of tax.

Fairness: Benefits

Fairness is also related to the benefits principles, that people should pay taxes according to the benefits they receive from services (where the beneficiaries can be identified and

[14] Kitchen and Slack, *Nova Scotia*, p. 12-13; Jordan, *Business Taxation*, p.5-6; and Association of International Certified Professional Accountants, *Guiding Principles of Good Tax Policy: A Framework for Evaluating Property Tax Proposals* p. 3. Accessed at https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf on 24 June 2021.

where the service is not primarily redistributive in nature).

Neutrality

Taxes should impact economic and locational decisions as little as possible. This principle covers both the City of Calgary and the broader regional context. This means that, to the extent it is possible given the different service levels offered by different municipalities, The City should offer a competitive tax/service offering.

Stability & Predictability

The tax should provide a stable and predictable revenue source for The City. Taxpayers should be able to understand, and The City should telegraph as much as possible, the impacts that arise from reassessment.

Accountability / Simplicity / Transparency

The tax system should be designed in such a way that is clear to all stakeholders which taxpayers pay the tax. Tax systems designed in such a way encourage more accountability from City Council and City Administration in their determination of the balance between service levels and taxation levels. Tax rules should be as clear and simple to understand as the complexity of the subject of taxation allows, so that taxpayers can anticipate in advance the tax consequences of a transaction including knowing when, where and how the tax is to be accounted.

Efficiency / Ease of Administration

The tax system should be easy to administer, resulting in minimized compliance costs for the taxpayer and minimized administrative costs for The City.

Administration's recommendation is that each of these principles should be considered as different programs or policies are evaluated.

5.1.1. Does the benefits principle continue to apply to modern municipal property tax systems?

The Real Estate Working Group has suggested that The City further investigate the benefits that accrue to non-residential and residential taxpayer groups. As stated above, the benefits principle is: people should pay taxes according to the benefits they receive from services (where the beneficiaries can be identified and where the service is not primarily redistributive in nature). The principle has been used as a reason to lower the share of non-residential property tax in some jurisdictions.

There are three complications with putting the principle into practice in the municipal property tax system:

1. **Majority of assignable costs have already been assigned**

Where The City of Calgary's costs can be assigned directly to users, this has been done through the imposition of user fees (e.g., transit passes / fares, recreation passes / admissions, utility and waste collection rates), proprietary charges (e.g., leases and licenses of property and information) and regulatory charges (e.g., fees for permits and licenses). The benefits principle is fully operative in The City's financial system through these mechanisms and the appropriate distribution of the remaining cost/benefits is more challenging because they are more diffuse.

2. Distribution of indirect benefits not clear

It is difficult to measure the benefits of services that are not fully funded by user pay mechanisms (i.e., services that are partially or totally tax funded like Fire, Police Services, Parks & Open Spaces and Streets) because the distribution of benefits is much more collective. Studies that have been undertaken to measure the consumption of services[15] have relied on the direct consumption of the service but have not considered the indirect benefits that accrue to the business community from the provision of City services. Chief among those benefits is the ability of the businesses to attract and retain talent through an attractive suite of City services that result in a high quality of life and a more robust labour market.

The Vancouver Tax Commission, which used the benefits principle in its analysis, came to the following conclusion when relating the principle to tax share,

> The Commission agrees that the consumption approach is a reasonable basis for determining the share of taxes to be paid by business but cannot endorse the specific findings of a consumption study based on direct benefits alone. In the absence of evidence on indirect benefits, we can only conclude that the appropriate sharing is likely to be lower than the current share. Given this ambiguity on the issue of fairness, the Commission has had to rely on other criteria to inform its recommendations.[16]

This was after an extensive study was conducted resulting in a recommendation by the Vancouver Fair Tax Coalition (a coalition of business groups led by the Vancouver Board of Trade) for a 32% tax share based on benefits and the tax deductibility of non-residential property tax. As a reminder, the Vancouver Tax Commission ended up recommending a 48% tax share in 2007. Vancouver City Council "did not support the use of 'consumption' studies as the basis for tax distribution in 1995 and again in 2007".[17]

3. Redistributive programs and policies increasing

There is an increasing appetite for redistributive policies and programs by municipal governments and The City of Calgary is no exception. The City of Calgary has taken a larger role in the provision of social services. For example, the City's suite of subsidy programs was united under the Fair Entry program in 2014. In adopting the *Enough For All* strategy, Council

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[15] Stuart MacKay, Jim Pammenter and Treena Cook, *City of Vancouver Consumption of Tax Supported Municipal Services: Volume I – Main Report,* (City of Vancouver, 2007): p. 11. Accessed at https://vancouver.ca/files/cov/2019-290-release.pdf on September 7, 2021.
[16] Hamilton, Adams and Slack, *Vancouver Commission 2007,* p. 51.
[17] Vancouver, *Distribution of Property Tax Levy,* p. 11.

decided to increase funding for social service agencies. Council has also continued to take action on affordable housing through the *Foundations for Home* strategy and mental health via *A Community of Connections* the City's mental health and addictions strategy.

In summary, the scope of The City's work is moving beyond the simple fee-for-service model suggested by the benefits principle. While the benefits principle should continue to apply to the municipal property tax system, the principle must continue to be weighed in light of the other principles above and does not merit priority in relation to the other principles when considering municipal property tax policy.

6. Options for Distributing Tax Responsibility to Different Classes

In Canada, there are three main approaches that are currently used in determining how to distribute the taxes among different property classes. These approaches are distinct; using one distribution methodology makes it impossible to use another. Below each of the approaches are described and the effects of the different approaches on key elements of the tax system are discussed; the analysis is based on modelling which is contained in Appendix 4 and the available literature.

1. The Proportional Approach

In this approach, the municipality applies the Council budget increase proportionately to all property classes. This approach was the main approach used by The City throughout the 2010s, though there are additional factors that affected non-residential and residential tax levy increases. Most notable the effects of business tax consolidation and differences in the take-up of provincial "tax room".[18]

Step 1 – Determine overall Council property tax budget change.

Step 2 – Determine new property tax levies (residential and non-residential property tax levy) by applying overall property tax budget change and adding real growth to adjusted property tax levies.

Step 3 – Divide new property tax levies by the taxable assessment base for each class to determine the non-residential property tax rate.

[18] When the Council-directed property tax levy increase is higher than the increase in the provincial Education Property Tax requisition, the difference has been called "tax room". It is called "tax room" because City Council can increase the municipal property tax levy and still have an overall tax increase that is reflective of the increase that was communicated during budget deliberations in November.

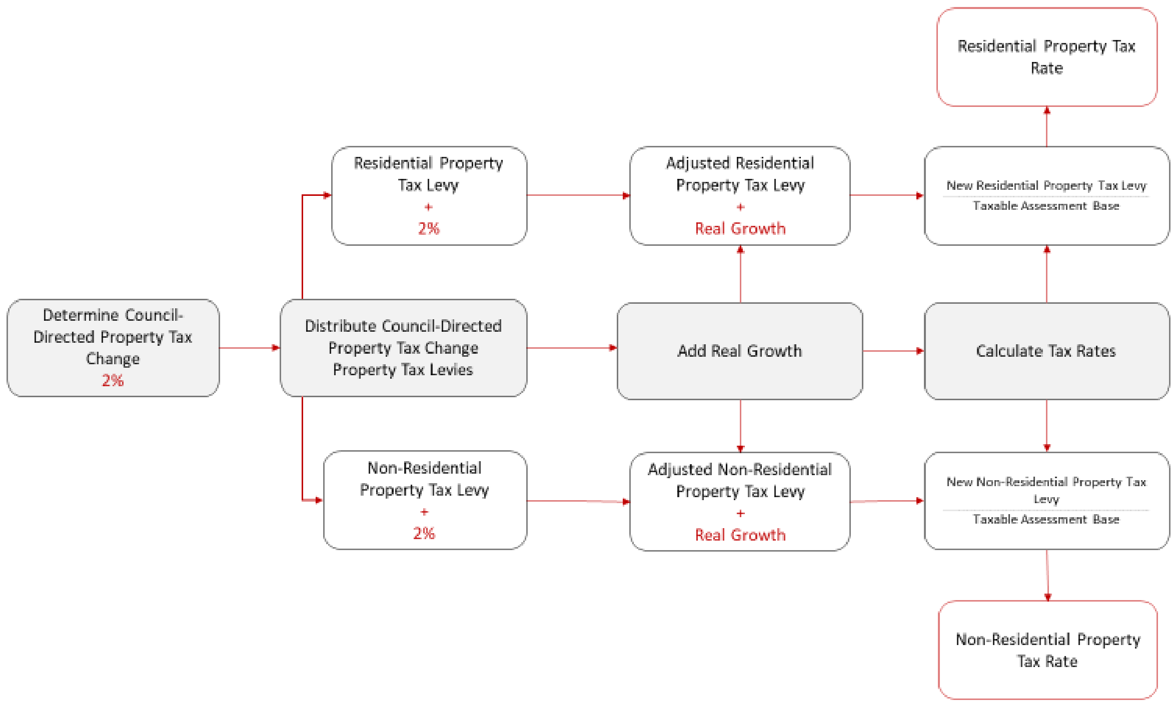

Figure 5 In the Proportional Approach, property tax budget is distributed evenly and growth is the main determinant of changes in tax share.

Driver and Effects

The key driver of change in distribution between classes in this approach is real growth (i.e. completed construction projects and other significant property changes that are added to the assessment base).

Effect on Tax Share

If one class outperforms another in real growth, it will take a higher share in taxes. In the past, average real growth has been relatively equal between classes and so the tax share would not have changed in a purely proportional system. Where this has occurred in the past has been due to differential increases caused by "tax room" and a freeze on business tax. The freeze on the business tax continues to apply to the business tax revenues that were consolidated into the non-residential property tax.

Effect on Tax Rates

In this approach tax rates float independently of each other and so tax rates will decrease as assessments rise and tax rates will increase when assessments fall.

Effect on Tax Rate Ratio

This approach results in a variable tax rate ratio as the ratio will be affected by market fluctuations (see the section above on tax rate ratios). So, if the market value of the non-residential property assessment base increased at a faster rate than the residential property assessment base, the tax rate ratio will decline.

Managing Tax Shifts within Classes

The Proportional Approach has no built in mechanism to address shifts within property tax classes. So, when a tax shift like the downtown tax shift results in large tax changes, one-time tax rebates have been used alleviate those tax changes.

Managing Tax Shifts between Classes

In the Proportional Approach taxes are not shifted between classes and there is no built-in mechanism to shift between classes.

Overall Effect on Tax Bills

The Proportional Approach generally results in stable tax changes over time. When assessments change, the proportional approach tends to soften the effects of changing assessments through a freely floating tax rate.

The one exception to these rules is when a large assessment changes occur that lead to a tax shift, like the downtown tax shift that occurred from 2016 until now. In that case, a floating tax rate can result in large tax increases (10 – 15%) even when the assessment for a property does not increase at all. The downtown tax shift also ended up compounding the effect of increasing assessments as a higher tax rate was applied to higher assessments. This effect was felt most profoundly in areas, especially main streets, undergoing redevelopment.

2. The Tax Rate Ratio Approach:

This approach works by determining the overall property tax budget change and then using the target ratio to adjust the levy for each class so that the tax rates achieve the desired ratio. This approach is used in Saskatoon at the discretion of City Council and in Ottawa and Toronto as mandated by the province.

Step 1 – Determine overall Council property tax budget change.

Step 2 – Determine the property tax rates by calculating the tax that would be required to achieve that budget requirement *and* achieve the target ratio. Add real growth to adjusted property tax levies.

Step 3 – Divide new property tax levies by the taxable assessment base for each class to determine the non-residential property tax rate.

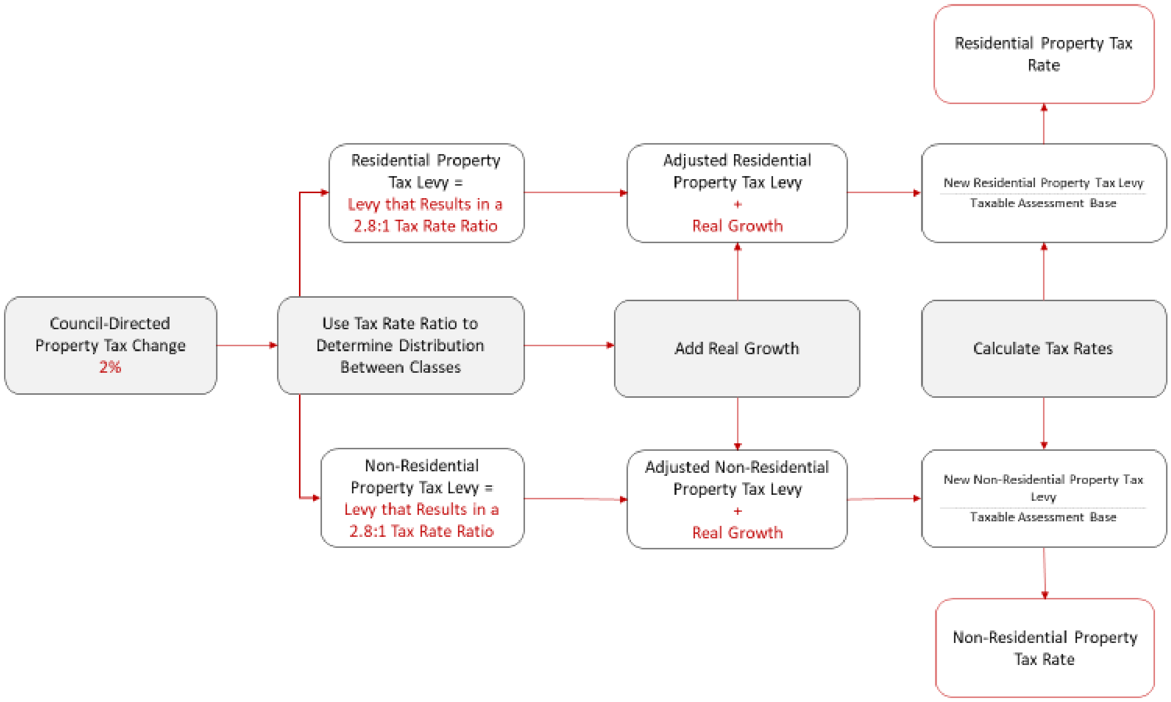

Figure 6 In the Tax Rate Ratio Approach the levy for each class is determined by calculating the amounts that would result in the target tax rate ratio.

Driver and Effects

The key driver of change in distribution for this approach is the relative market performance of each assessment base. For example, if the market value of the non-residential property assessment base increases compared to the residential property assessment base, the non the result of a fixed ratio would be an increase in the non-residential property tax levy. In years where the non-residential property assessment base does not perform as well as the residential property assessment base, the result would be a decrease in the non-residential property tax levy.

Effect on Tax Share

Relative market performance also governs changes in the share of property taxes paid by each class. The tax share of the non-residential property class would rise if the non-residential property assessment base increases at a greater rate than the residential property assessment base.

Effect on Tax Rates

Using a static tax rate ratio anchors the tax rates for each class to each other typically reducing the amount of change in tax rates. Tax rates would continue to float but they would typically do so at a slower rate.

Effect on Tax Rate Ratio

Assuming no Council directed changes to the tax rate ratio, the effect of using a tax rate ratio approach is to hold the tax rate ratio constant over time.

Managing Tax Shifts within Classes

Tax shifts within classes occur when a property type like downtown offices grows a lot more or a lot less than other property types (e.g., retail and industrial) within a class. In situations like the downtown shift, the decreases in assessment materially affected the non-residential property assessment base and led to poor relative performance when compared to the residential assessment bases. Keeping the tax rate ratio the same in that situation would have resulted in a redistribution of tax not only within the non-residential class but also from the non-residential class to the residential class.

Managing Tax Shifts between Classes

Tying the classes together essentially makes them one class. So, the tax shifts that occurred within the non-residential property assessment class from 2016-2021 would have been shared more readily with the residential property taxpayers. This sharing between classes would have stabilized the non-residential property tax rate and eased the effects of the downtown property tax shift by increasing the residential property tax rate and residential property taxes.

Overall Effect on Tax Bills

If keeping a static tax rate ratio, the Tax Rate Ratio Approach results in less stability in tax bills. This is because, in addition to the sources of volatility listed above, the shifts between classes become an additional source of volatility. The anchoring effect of the tax rate ratio on tax rates means that market volatility can be more directly translated into tax volatility.

3. The Tax Revenue Share Approach

As in the other approaches, the overall property tax budget change is determined first. Subsequently, that amount is multiplied by the percentage share that is to be distributed to each of the property tax classes. Vancouver uses this approach and Calgary started using this approach in the 2020 financial year.

Step 1 – Determine overall Council property tax budget change.

Step 2 – Multiply the overall Council property tax budget by the percentage share to be paid by each tax class to determine the property tax levy and add real growth to adjusted property tax levies.

Step 3 – Divide the property tax levy for the non-residential property class by the taxable non-residential property assessment base.

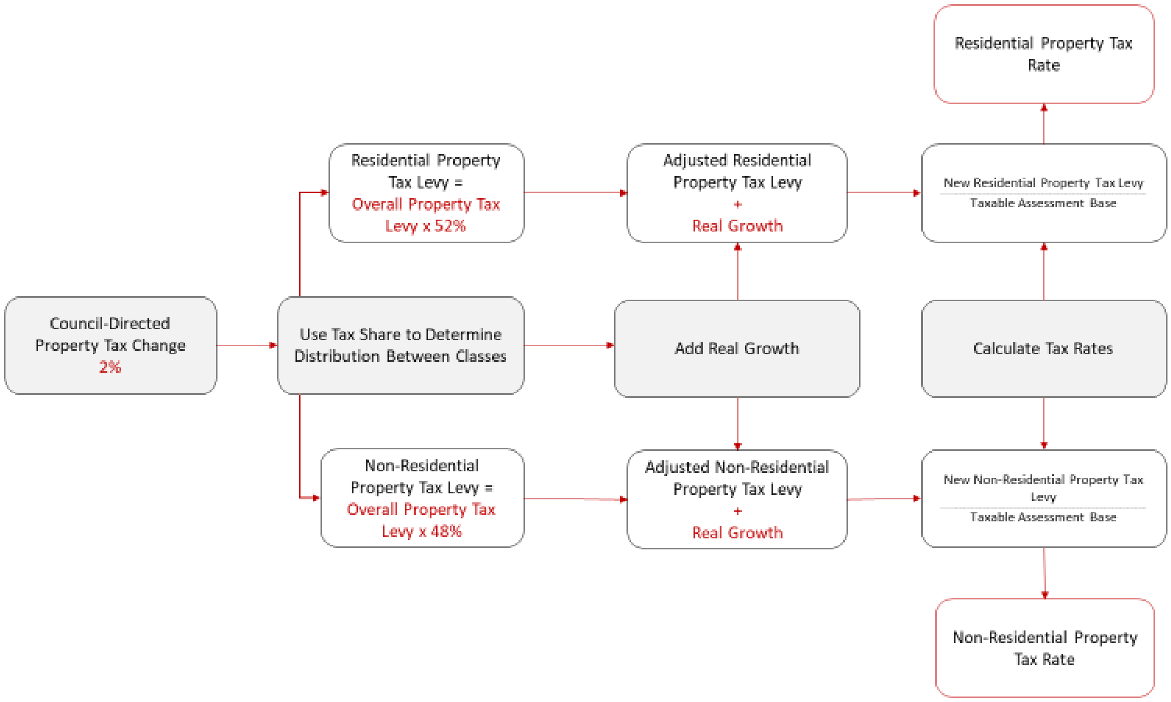

Figure 7 In the Tax Share Approach, the levy for each class is determined by multiplying the overall property tax levy by the share assigned to each class.

Driver & Effects

The key driver for this approach is Council decision-making. This approach allows Council to evaluate the current context and decide on the appropriate share for each class in each year.

Effect on Tax Share

If Council does not change the tax share, the tax share will remain the same over time. The tax share will not respond to either real growth or the relative market performance of each property assessment base.

Effect on Tax Rates

Similar to the Proportional Approach, tax rates float independently of each other and so tax rates will decrease relatively proportionately when assessments rise. Conversely, tax rates will increase proportionately when assessments decrease.

Effect on Tax Rate Ratio

The approach results in a variable tax rate ratio as the ratio will be affected by market fluctuations. So, if the non-residential property assessment base increased at a faster rate than the residential property assessment base, the tax rate ratio will decline.

Managing Tax Shifts within Classes

The Tax Share Approach allows Council to manage tax shifts within classes by adjusting the tax share and shifting some portion of the tax. Council used the Tax Share Approach in 2019 to help alleviate some of the effects of the downtown tax shift.

Managing Tax Shifts between Classes

There would be no automatic shifts between classes using the Tax Share Approach. Instead, any shift in taxes between classes would be the product of explicit Council decision making.

Overall Effect on Tax Bills

If the tax share is not adjusted, the tax share approach results in stable tax changes over time. When assessments change, the proportional approach tends to soften the effects of changing assessments through a freely floating tax rate.

Like the Proportional Approach, the one exception to these rules is when a large tax shift occurs, like the downtown tax shift that occurred from 2016 until now. In that case, a floating tax rate can result in large tax increases (10 – 15%) even when the assessment for a property does not increase at all. Unlike the proportional approach these effects can be mitigated using a tax share change to shift taxes from one class to another.

6.1. Tax Distribution Approach Summary

The analysis above makes it clear there is no perfect approach to the distribution of the property tax. Each approach comes with its own tradeoffs.

The Proportional Approach takes the current distribution of tax as a given and provides a smooth system of redistribution over time based on real growth. This is true except in cases of very assessment large shifts, which would typically happen only in the non-residential property assessment class. In those times, the Proportional Approach is not well adapted to the problem of tax shifts and one-time rebates must be used.

The Tax Rate Ratio Approach is more reflective of the relative market changes in each assessment base. This means that the Tax Rate Ratio Approach is more likely to lead to large increases in tax when one assessment base is performing much better than the other. At the same, time it allows for flows between classes that could help manage tax shifts and alleviate, or at least reduce, then need for one-time rebates with bow wave effects.

The Tax Share Approach puts much more of the onus on Council. It allows Council to set the distribution of tax as it deems appropriate and there would be no automatic redistribution based on either real growth or the relative performance of each assessment base. This approach allows Council make Tax Share decisions that could help to alleviate, or at least reduce, the need for one-time rebates with bow wave effects.

	Effect on Tax Share	Effect on Tax Rates	Effect on Tax Rate Ratio	Tax Shifts within Classes	Tax Shifts between Classes	Overall Effect on Tax Bills
Proportional Approach	Floats based on real growth	Less stable	Floats based on relative performance of assessment bases	Solved with one-time rebates	No shifts	More stable growth
Tax Rate Ratio Approach	Floats based on relative increases in assessment bases	More stable	Fixed by Council	Can be shifted automatically to other classes	Shifting is part of the system	Less stable growth, more prone to large increases
Tax Share Approach	Fixed by Council	Less stable	Floats based on relative performance of assessments bases	Intraclass shift can be shifted to other classes via Council decision	Shifts can occur with Council decision	More stable growth

7. Conclusion and Next Steps

Now that the approaches have been detailed and explained, Administration will work towards making a recommendation on the approach and potential target for Council's consideration as part of the upcoming Taxation Policy. It is not anticipated that the Taxation Policy will be prepared in time for the preparation of the property tax bylaw early in the spring of 2022 and so in the absence of that work, Council should continue to use the Tax Share Approach in its consideration of the final tax rates for 2022.

7.1.1. Stakeholder Engagement

Administration will gather input from stakeholders about the appropriate distribution approach and the appropriate distribution target. The following stakeholders will be engaged directly:

- BILD Calgary
- Building Owners and Managers Association (BOMA)
- Business Improvement Area (BIA) Executive Boards
- Calgary Economic Development (CED)
- Calgary Chamber of Commerce
- Calgary City Council
- NAIOP Calgary

In addition to direct engagement with the stakeholders listed above Administration will examine and execute additional engagement strategies to solicit broader citizen/business input. Potential strategies include, but are not limited to, using the engage portal and/or using existing City of Calgary surveys.

7.1.2. Additional Comparative Data

The Residential Property Taxes and Utility Charges survey already has a large set of data for select regional and national comparators. To supplement this work, and consistent with the recommendations from the Vancouver Tax Commission, administration will use primary and third-party sources to gather the following information for five national and five regional comparators:

- Municipal Tax Share
- Non-Residential Tax Rates
- Total Assessment
- Taxes per Capita
- Vacancy Rates
- New Building Permits
- Property Tax / Square Foot

Appendix 1: Financial Task Force Recommendation #19 and Administration's Response

Recommendation #19 of the Financial Task Force stated the following:

> "Contract with a reputable independent expert to provide an acceptable and reasonable split of the property tax responsibility between residential and non-residential taxpayers.
>
> - Determine the objectives that would inform the determination of the acceptable and reasonable split.
> - Incorporate the outcomes of recommendation #12 that targets making subclasses usable.
> - Explore the viability of pegging mill rates and options (if any) that would work for the Calgary context.
> - The extent to which it makes sense to determine tax rate thresholds that once breached would trigger the need for mill rate stabilization using an existing or a new reserve.
> - The range of fiscal tools, including reserves like the fiscal stability reserve, to minimize tax volatility while also maintaining a stable fiscal position.
> - The policy guidelines that would focus on stronger discipline for using the fiscal stability reserve and a minimum level of reserves dedicated to mill rate stabilization.
> - Complete the exercise no later than 2021 Q2.
> - Use the results to address the risk that one taxpayer category may be overpaying for services.
> - Use the results to anchor future tax redistribution decisions."

Administration's preliminary response was as follows:

> "Agree – with proposed modifications and limitations. Administration agrees in principle that independent, expert analysis of the revenue split can improve the decision making and acceptance of the overall taxation system.
>
> Because it is impossible to peg both the tax rate and the revenue share, the objective of the independent review is to secure a third-party expert opinion to inform long-term practice. At present, the tax rate for one assessment class (e.g. non-residential) is a function of the required revenue and the assessment. Administration's preliminary assessment is that if the tax rate of one class is pegged to another, it cannot be adjusted to meet the targeted revenue shares. Administration's preliminary assessment is that it is challenging to empirically verify the optimal assignment of costs and values of services across taxpayer categories.
>
> The implementation update that is due to Council by 2020 July 29 would include an analysis of the costs and benefits of proceeding with the review as well as the viability of completion by 2021 Q2 given the challenges associated with the COVID-19 pandemic."

Opportunities for Change:

There is an opportunity to improve decision making and public acceptance of decisions through an independent analysis. There is an opportunity to solicit independent expertise on a significant component of taxation policy, especially the use of the fiscal stability reserve.

Action items:

a) Administration will refine the scope of a potential analysis and review the feasibility of proceeding with an independent expert in the development of municipal tax policy and recommend a delivery date that considers resource constraints if appropriate.
b) Administration will review the validity and generalizations of any results in accordance with 1 (b).
If the study proceeds, Administration will incorporate results into policy recommendations to Council as appropriate."

APPENDIX 2: INDEPENDENT EXPERT CONSIDERATIONS

Advantages and Disadvantages

Advantages

- A qualified independent expert may contribute to perceived enhanced legitimacy in the process from the perspective of the public and other stakeholders.
- A qualified independent expert may bring new perspectives which can add value to the problem-solving process.
- The City would not need to use as many internal resources as required if performing the Study itself.

Disadvantages

- Administration also possesses the requisite expertise to conduct the Study and is confident that it could do so at a lesser cost than an independent expert.
- Though the independent expert will be providing the report and accompanying recommendations, The City will still have to invest time and resources into the Study. For example, The City will have to spend resources on procurement, contract management, and provision of data and information to the independent expert.
- The service procurement process will require time for proper execution, reducing the amount of time available to dedicate to the Study.
- Previous studies by leading experts have been unable to conclude on a straightforward approach.

Risks Specific to Hiring Independent Expert

- Unforeseen costs associated with hiring an independent expert.
- Negative consequences arising from a misunderstanding between The City and the independent expert. For example, the parties may have different understandings of the Study's scope leading to inconsistent expectations.

APPENDIX 3: Response to Real Estate Working Group Advice

Real Estate Working Group Advice	Administrative Response
Commit to the principles outlined herein to guide future tax distribution decisions, with an emphasis on current data and consideration for the effects on competitiveness and predictability. (Saskatoon report attach 2)	Agreed, the principles outlined in this document and the 2020 Financial Task Force Report and Recommendations broadly coincide with the principles from the Real Estate Working Group.
Seek out or invest in further evidence of the benefits accrued to the non-residential and residential taxpayer groups.	Agreed, with limitations. This work aligns with previous Financial Task Force recommendations and will proceed. As a caution, measuring the direct benefits of City services does not account for indirect benefits including public safety, well-functioning infrastructure, and an attractive labour market.
Establish a list of key metrics to be reviewed annually prior to making tax rate/distribution decisions. At a minimum this should include final assessment base values, projected mill rates, comparability metrics, and redistributive effects. If not available, invest in gathering/maintaining this info.	Agreed, Administration already provides a suite of information on the implications of budget decisions on taxes for residential and non-residential property taxpayers. In addition, Administration continues to develop the data for Council's consideration and will work to provide during future tax distribution decisions.
Commit to a distribution approach: Tax share or Tax rate ratio. REWG notes a targeted ratio approach as the most effective in addressing the volatility issues experienced recently.	Agreed, with limitations. In this report, Administration detailed the different tax distribution approaches and the Tax Rate Ratio approach performed well over the course of the last few years. Over the long term, the analysis revealed that it could lead to more volatility for the non-residential property class, especially in times of increasing assessments.
Align tax distribution process/timing to have all necessary information prior to decision making.	Agreed, Administration believes it is possible to gather all the relevant information prior to making these types of decisions.

Real Estate Working Group Advice	Administrative Response
In keeping with Recommendation 19 of the Financial Task Force, prioritize an investigation into whether and at what time is it appropriate to use reserves to mitigate tax shifts due to changes in the assessment base (i.e., if base drops <5%). The REWG believes the use of reserves should be considered in order to stabilize tax rates in years of extraordinary flux.	Agree, with limitations. The use of reserves to address tax changes is only a deferral of changes that would occur. Administration will include a discussion of the use of reserves in the materials that are presented with the taxation policy.
In keeping with Recommendation 35 of the Financial Task Force, prioritize the investigation and legal feasibility of an assessment averaging system for hot-spot properties (e.g., industrial properties).	Agreed, Administration is currently working on this investigation with results currently set to be reported in March 2022.

Appendix 4: Modelling the Effects of the Distribution Approaches

The various approaches to tax distribution were modelled with the following parameters:

- The actual distributions are used as a base case and could be considered as a proxy for the Proportional Approach until 2020 when The City transitioned from the Proportional Approach to the Tax Share Approach.
- In each scenario, the business tax was included as part of the non-residential tax levy.
- To isolate the distributional effects of the different approaches, the total property tax levy remained constant, that is to say it was assumed that the actual total property tax levy for each year would have been the same, regardless of the distribution approach.
- The key input associated with each distribution approach was:
  - For the Tax Rate Ratio Approach, a ratio of 2.8, in line with the Calgary Chamber of Commerce recommendation, was used.
  - For the Tax Share Approach, a share of 48 per cent for non-residential property tax was used, which is consistent with current Council direction.

It should be noted that, for the Tax Rate Ratio Approach and Tax Share approach, a static approach was used. Council would still, however, have the option to change either the target ratio or target share, so this modelling is meant only to showcase the distributional effects of each approach

Findings

The main takeaway from the modelling is that targeting a static tax rate ratio can lead to volatility in the non-residential property tax levy, and thus the amounts of property tax paid by non-residential taxpayers could vary dramatically. This volatility does, however, correspond with the ups and downs in the non-residential property market.

The reason for volatility in the tax levy is that using a static tax rate ratio anchors the tax rates for each class to each other reducing the volatility of the tax rates and, in so doing, exposes taxpayers to more tax volatility arising from market driven changes in property assessments (as demonstrated in the section on the rate-based approach to tax rate sending above).

Tying the classes together essentially makes them one class so the tax shifts that occurred within the non-residential property assessment class from 2016-2021 would be shared more readily with the residential property taxpayers. This sharing between classes would have stabilized the non-residential property tax rate and eased the effects of the downtown property tax shift in that occurred in that timeframe.

When taxes are shifted toward residential property taxpayers (i.e. the residential property market is performing better than the non-residential property market) the shifts are generally manageable because the taxes are shared by a broader base of accounts. An exception to this general rule occurred due to a dramatic decline in the non-residential assessment base in 2011 would have resulted in a large increase (18%) in the residential property tax levy in 2011. The residential tax levy peak in 2011 demonstrates that tax rate ratio related shifts result in changes that some residential taxpayers may find untenable.

It is when taxes would have shifted toward the non-residential property taxpayers due to very substantial growth in the non-residential assessment base in 2006, 2009 and 2013 that these effects are the most pronounced. In those years, the non-residential property tax levy would have increased by 14%, 12% and 19% respectively.

For the Proportional Approach and the Tax Share Approach, the tax levies are distributed by Council and independently of market volatility. So, when there are positive changes in the non-residential property assessment base, the non-residential tax rate is adjusted downward. This also works in reverse, when the non-residential property assessment base declines, the non-residential tax rate increases.

Figure 8 Comparing the approaches **actual distributions**, **ratio of 2.8:1**, and **share of 48/52** as year-over-year per cent change in the assessment base, the tax rate and the tax levy.

These results are reflective of The City of Vancouver's experience using tax rate ratios. The City of Vancouver devotes a report to tax share annually and in that report the authors discuss the Vancouver experience with the Tax Rate Ratio approach,

> In the late 1970s and early 1980s, the Province established the tax rate ratios for municipal governments annually. This resulted in significant year-over-year inter-class tax shifts arising from differential market value changes. At the request of Council and the Union of British Columbia Municipalities, the Province granted municipal governments the authority to determine their own

tax distribution approach beginning in 1983. Since then, it has been Council policy to use the "tax share" approach.[19]

In summary, the Tax Rate Ratio Approach would lead to greater interclass tax shifts (i.e., tax shifts between tax classes), and expose properties to more assessment changes while providing relief from tax rate volatility (usually caused by tax shifts within classes). The Proportional Approach and Tax Share Approach ensure that there is less volatility between classes and typically help buffer assessment-related changes but do not, by themselves, solve the volatility issues related to tax shifts. It should be noted however that the Tax Share Approach can be used to alleviate tax shifts by shifting the tax responsibility to other classes. The examination of addressing assessment-related volatility through potential use of multi-year assessment averaging will be addressed in another report from Administration prior to the end of Q2 2022.

	Buffering from Assessment Changes	Interclass Tax Shifts	Tax Rate Changes Due to Reassessment (Intraclass Tax Shifts)
Proportional Approach	🟢	🟢	🔴
Tax Share Approach	🟢	🟢	🟡
Tax Rate Ratio Approach	🔴	🔴	🟢

[19] Vancouver, *Distribution of Property Tax Levy,* p. 12.