Revenue Neutral Tax Explanation

What does revenue neutral mean?

In Alberta and jurisdictions across Canada, municipalities use the budget-based approach to setting tax rates consistent with Municipal Government Act (MGA) s. 355 provincial guidance and International Association of Assessing Officers (IAAO) best-practice.

Revenue neutral means that property tax rates are calculated by dividing the revenue required from property tax by the taxable assessment value. Annual property assessment changes are revenue neutral because they have no impact on the total property tax amount that The City might raise, and the overall revenue collected through the property tax process will be the same regardless of changes in property values. Rather, assessment changes provide for a redistribution of property taxes within Calgary based on the value of the property owned. The revenue neutral process helps explain how an individual property's taxes have changed due to that property's year-to-year change in assessment. Each property's change in taxes occurs because the process of assessing properties each year results in taxes being re-distributed among properties. Changes in The City's property tax revenues are decided through the budgetary process, leading to two distinct and separate assessment and budgetary processes, each transparent and fair.

Why do we use the revenue neutral approach?

The City's revenue neutral tax system is consistent with principles set out in *Municipal Government Act* (MGA) sections 355-356, guidance from Alberta Municipal Affairs, and international best practice. It ensures that:

- The City does not collect more than it needs from taxpayers.
- Total tax revenues do not change automatically with assessment changes year-over-year, which creates less volatility.
- Any tax revenue change brought forward by The City is communicated separately through the budgetary process.
- Ensures no new taxes will be collected due to the annual reassessment process
- Creates taxpayers' confidence in the integrity and transparency of the property assessment and tax system.

Conversely, in a rate-driven tax system, assessment value increases or decreases directly impact the amount collected through property taxes. In this system, the assessment is not only responsible for distributing property taxes but controls the magnitude of property taxes as well. This system fails to meet the test of open and transparent property taxation. The IAAO discourages governments from using rate-based property tax systems because it creates revenue volatility, harms transparency in government finance (i.e. officials can claim they did not raise taxes even when there is a significant increase in tax revenue),and implies that property assessors control the magnitude of tax increases rather than just the distribution of tax responsibility[1].

The rate-based approach is used in many American jurisdictions and often results in large increases in property tax bills and perceived windfalls for governments when properties are reassessed. Windfalls from increased assessments can create pressure for governments to spend, offer significant tax relief, and

[1] IAAO. (2020). *Standard on Tax Policy*, pp. 20-21.

implement complex and expensive policy tools to cap assessment changes or provide exemptions; however, the rate-based approach also creates challenges where there are lower market assessments and jurisdictions must keep large amounts in reserve to fund sustainable operations and service delivery.

The Municipal Property Tax Rate Calculation

Council sets the municipal property tax revenue requirement in 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 one 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 to provide services for the year. This revenue requirement is then used to calculate the tax rate in accordance with MGA s. 355. The tax rate calculation is as follows:

Tax Rate = Revenue Budgeted from Property Tax ÷ Total Taxable Assessed Value

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

Property Assessed Value x Municipal Tax Rate = Municipal Tax Payable

What does this mean for property owners?

Property owners can expect that their property value will be reassessed annually based on real estate market transactions that have occurred. Since property assessments are simply a mechanism to distribute property tax responsibility, an increase in a property's assessment value does not necessarily mean that the property owner will also see an increase in their property tax bill. On a revenue neutral basis (i.e. if the property tax revenue requirement is unchanged), if a property's assessment value changes by the same amount as the typical change for their assessment class (i.e. residential or non-residential), their property tax responsibility will be unchanged as a result of the reassessment. If their property value change is above the typical, they will see an increase in tax responsibility as a result of the reassessment and if it is below, they will see a tax decrease in tax responsibility. The actual amount on tax bills depends on budget decisions.

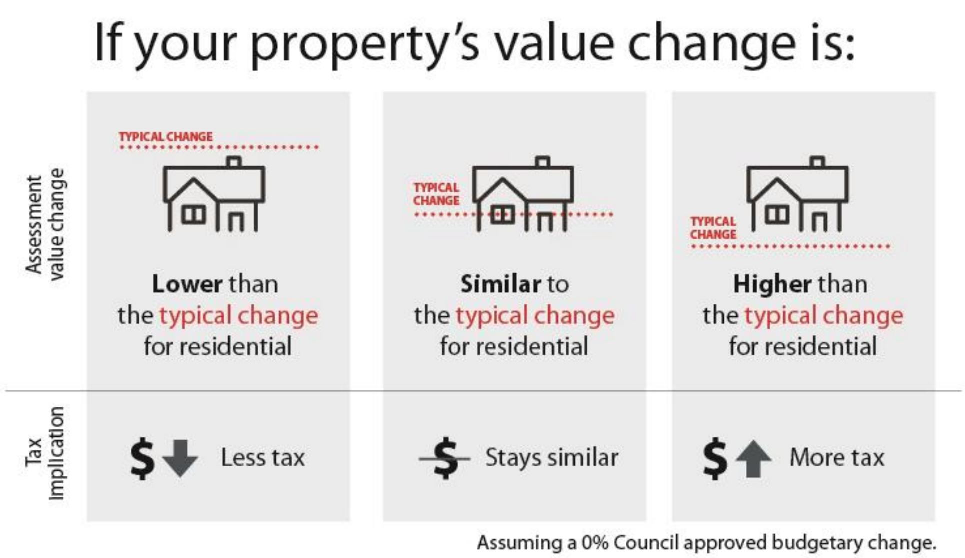

Table 1: How Revenue Neutral Works – A Typical Cycle

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