# Reforming Ontario's Property Tax System: A Never-Ending Story?

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**ABSTRACT**

This paper reviews the development of property tax policy in the province of Ontario, Canada, over the last two centuries. This review underlines the highly political nature of property tax policy at the local level in the province. Two important realities make the issue highly salient at the provincial level as well. First, since half or more of the property tax collected by any municipality reflects decisions made at higher (regional or provincial) levels of government, and these decisions are often related in no visible or accountable way to matching benefits to the community, one of the key arguments for local property taxation has been – indeed, has always been since at least 1850 – attenuated. Second, many actions of the provincial government, especially since provincial assumption of assessment in 1970 and the explicit linkage of property and provincial income taxes later in that decade, but even more so since a major shift in property tax policy in 1998 have made it clear that it is the province, not the local government, that has both the first and the last say when it comes to property taxes. In Ontario, property tax policy is pre-eminently a provincial rather than a municipal matter not just by law but, and probably more importantly, by repeated provincial assertions of its controlling role with respect to the tax down to all but the very finest details.

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## Contents

**Reforming Ontario's Property Tax System: A Never-Ending Story***

Age and virtue are sometimes associated, as when we are told that "an old tax is a good tax." The oldest local tax in Ontario is the property tax. Soon after the colony of 'Upper Canada' – the subsequent Ontario – was established in 1791, one of its first fiscal measures was to provide for a 'moderately graduated tax on total property, real and personal' (Assessment Act of 1793). Property taxation in Ontario has evolved and changed in many ways in the ensuing 214 years, as of course has the province and its local governments, but the property tax continues to be, as it has always been, the only significant local tax.[1] Despite its longevity, however, the property tax has never been popular in Ontario. Indeed, perhaps no tax has been more vilified than the property tax. It has been described as unfair because it is unrelated to ability to pay and unrelated to benefits received, unsuitable because it supports services unrelated to property, and inadequate because it does not generate sufficient municipal revenues. In recent years, its effects on housing, land use, and urban development have been castigated. Its political unpopularity has long been acknowledged by all. But still the property tax, battered and twisted though it may be, endures.

This paper tells the tale of how the Ontario property tax has survived and evolved over the years. As our title indicates, the story is by no means finished. Some thought that the major reforms launched in 1998 marked a major change and turn for the better in the fortunes of the property tax after thirty years of indecisive hand-wringing about the need for property tax reform. In fact, however, the years since 1998 have probably seen more changes in property tax policy than any earlier decade and, as we shall argue, it is most unlikely that any equilibrium position has yet been reached. To put recent events in a long-term perspective, we shall first review briefly the historical evolution of the property tax prior to the mid-1960s before turning to a little more detailed analysis of the three decades preceding the 1998 reform, and then to a blow-by-blow description of the twists, turns, and reverses of the last decade. We conclude with a few remarks on the interactions between law, administration, economics, and, above all, local and provincial politics that have shaped past developments and will undoubtedly continue to do so in the future.

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## Begin at the Beginning

The standard guide to story-telling suggests that the best way to start a story is with the words "in the beginning…." This rule seems especially sound when it comes to the evolution of a complex fiscal institution like the property tax, where the label 'fiscal inertia' (Rose and Karran 1987) often seems a more appropriate description than the term 'path dependency' (David 2007) more commonly found in the economic literature.

### The First Hundred Years

In the beginning, as already noted, came the Assessment Act of 1793. According to Canada's pre-eminent tax historian (Perry 1955), four modifications between 1811 and 1838 gradually turned the tax established in the 1793 Act into a moderately effective real property tax that also applied in a limited way to personal property. In 1838, the Act was further amended to specify that real property should be assessed at 20 percent of its value. When a formal municipal government system was finally established in Ontario between 1841 and 1849[2] – until then taxes in the 19 counties established in 1792 had been levied by justices of the peace who were responsible to the provincial government – the existing tax was turned over to the new elected local councils. The structure of local government set up in the province over 150 years ago essentially still prevails today, including the feature that local municipalities are the tax levying authorities and that 'upper tier' local governments – then counties and now both counties and regional governments – can 'requisition' funds from municipalities. A more detailed description of the Ontario municipal structure can be found in Appendix A.

The property tax was first used to pay for education in 1841. Prior to that time, the main source of revenue was a rate-bill on parents supplemented, in some cases, by charitable donations (Cameron 1969). Beginning in 1841, local councils were required to distribute among the common schools of the district an amount equal to the district's share of the provincial school grant. The funds were to come from a general property tax. There was a major reform of school finance in 1850 when the Common Schools Act gave school trustees the right to require taxes to be levied on property for school reform – and again gave the lower-tier local governments full responsibility for levying such taxes, although until 1877 if for some reason the trustees wanted to take on the job themselves they could. After 1877, the lower-tier localities (cities, towns, villages) were stuck with the job of financing both local schools and upper-tier local governments – the counties – from locally-imposed property taxes. With one exception, this system is still in force today. For example, in the City of Mississauga (a large municipality adjacent to Toronto), only 28 percent of the 'local' property tax levied by the City in 2007 actually goes to the City: the balance goes to the Region of Peel (46 percent), in which Mississauga is located, and to education (26 percent).[3] As Locke and Tassonyi (1993) argue, 'sharing' tax bases in this way greatly blurs the accountability of local government. But then, as we shall discuss, so does almost every other feature of provincial-municipal relations in Ontario.

Accompanying the new municipal structure, a new *Assessment Act* was introduced in 1850, revising a draft Bill proposed in 1843 that had been largely copied from a recent law in the adjacent State of New York.[4] This Act eliminated the original proposal that 'income' be included in the tax base and confined the taxation of personal property to a short list including horses, cattle, carriages for pleasure or hire, stock of merchants, mechanics, manufacturers, etc., and stock or shares in water craft for freight or passengers. In practice, the main items taxed were likely business inventories. Towns and cities were permitted to petition to use annual rental value instead of capital value as the basis for assessment. Capital value was still to be used in counties and townships. Shortly after the 1850 reform, however, income over £50 (as an item of personal property) was brought back into the tax base unless exceeded by the value of other personal property. By 1853, the formal responsibility for assessment was transferred to the local level. Assessors were empowered to obtain information from a property holder. In 1866, a further important change was made when capital value was restored as the mandatory assessment basis for real property. At the same time, income exceeding $300 was to be added to the personal property tax base.[5] And there the system rested for the remainder of the 19th century: a 'general' property tax encompassing not only both real and personal property but also income.

As in the United States in the latter half of the 19th century, however (Seligman 1969), not everyone – indeed, almost no one – was happy with the general property tax. In the 1860s and 1870s, for example, many municipal governments petitioned the provincial legislature to repeal tax exemptions such as those for bank stocks and for personal property used in farming (Stokes 1993). Since municipal fiscal issues were serious political matters in early Ontario (Noel 1990), following standard Canadian practice a special committee was established to deal with this issue. During hearings of the Select Committee on Exemptions from Taxation in 1878, other aspects, particularly with respect to personal property came to the fore. For example, the treasurer of the City of Toronto called the assessment of personal property "entirely fallacious" and a local alderman suggested that the value on the rolls was not one-tenth of the true amount – an estimate supported by other evidence submitted to the Committee (Perry 1955, 87). Both the personal property tax and the municipal income tax were severely criticized. Inevitably, further commissions were soon set up to study these questions.[6]

**The 1904 System**

The most important such commission, the Mclennan Commission, reported in 1902 (Ontario Committee 1967, 41-42). This Commission recommended that all local income taxation of individuals should be abolished and that the personal property tax also be abolished and businesses instead subjected to a flat-rate 'occupancy tax'. Although the provincial government accepted this report, in fact the subsequent major reform of the Assessment Act in 1904 rejected some key recommendations of the Commission.[7] The 1904 reform repealed the personal property tax and introduced a more effective system of source withholding on wages as well as a new definition of income that was actually later adopted by the federal government when it introduced Canada's first national income tax in 1917 (Perry 1955, 157).[8] In addition, the 1904 Act introduced a 'graded' business occupancy tax, with different 'assessment percentages': the tax was imposed (in addition to the property tax) at the general rate of property tax on a specified percentage of assessment -- for different types of business being imposed. The percentages ranged from 25 percent for retail merchants in cities with more than 50,000 inhabitants to 150 percent for distilleries. These differential rates were selected to maintain the revenues from the personal property tax by class of activity (Perry 1955; Ontario Committee on Taxation 1967, 38). These percentages remained largely the same until the 1980s when the number of rates was reduced and the high rates for distillers were lowered.[9] The 1904 Act also exempted machinery from real property assessment. For the most part, the system introduced in

1904 prevailed for most of the next century, although the municipal income tax, never an important source of local revenue and one with many problems in collection and compliance, was replaced in 1937 by the first provincial income tax.[10]

Throughout this period, taxes on real property constituted by far the most important source of municipal revenue in Ontario.[11] In 1878-79, for instance, such taxes provided 81 percent of Toronto's 'own revenue' with the balance coming from taxes on personal property (15 percent) and income (4 percent). In 1892-93, the comparable breakdown was 89 percent, 7 percent, and, again, 4 percent (Kitchen 2002, 13). For the province as a whole, provincial data show that for the 1886-1910 period, such local taxes accounted for 85 percent of own revenues, with the balance coming from fees and utility charges. While provincial grants increased after the First World War, rising from only 2.7 percent in 1913 to 7.6 percent of total local revenues in 1937, the local finance story throughout the first half of the 20th century, as in the 19th, continued to be essentially the story of the real property tax, which accounted in most years for 90 percent or more of total taxes and about three-quarters of all local revenues.

Fortunately for the growing urban local governments, the assessment base grew rapidly over most of this period as did population, employment and the manufacturing sector. One result was a marked increase in the importance of urban assessments compared to rural (see Table 1) and a corresponding increase in the importance of buildings relative to land in the tax base. In constant (1900) dollars, however, although per capita assessment first grew from $288 in 1886 to $416 in 1906, it then declined sharply to only $341 in 1921, rising again to $481 by 1931 before falling to only $355 in 1941. Fifty years of assessment effort (from 1891 to 1941) thus left Ontario municipalities with a similar per capita tax base as that with which they began.[12]

Table 1: Per Capita Real Property Assessment (Constant $1900), Ontario, Selected Years, 1885-1941

| Year | Rural | Urban (Towns and Villages) | Cities | Provincial Average |
|---|---|---|---|---|
| 1886 | 308 | 196 | 312 | 288 |
| 1891 | 351 | 253 | 437 | 351 |
| 1896 | 403 | 282 | 484 | 398 |
| 1901 | n.a. | n.a. | n.a. | n.a. |
| 1906 | 482 | 298 | 393 | 416 |
| 1911 | 454 | 268 | 455 | 412 |
| 1916 | n.a. | n.a. | n.a. | n.a. |
| 1921 | 312 | 218 | 423 | 341 |
| 1926 | 313 | 255 | 478 | 374 |
| 1931 | 394 | 327 | 607 | 481 |
| 1936 | n.a. | n.a. | n.a. | n.a. |
| 1941 | 342 | 182 | 434 | 355 |

Source: Tassonyi (2007)

In revenue terms, the pattern was roughly similar (see Table 2). Average local taxes per capita (in real terms) rose from $4.11 in 1886 to $7.31 in 1906 and continued to rise to $9.98 in 1916, $21.99 in 1931 before falling again in the mid-1930s.

Table 2: Per Capita Real Property Taxes (Constant $1900), Ontario, Selected Years, 1885-1941

| Year | Rural | Urban (Towns and Villages) | Cities | Provincial Average | Effective Tax Rate |
|---|---|---|---|---|---|
| 1886 | 3.18 | 4.17 | 7.11 | 4.11 | 1.3% |
| 1891 | 3.54 | 5.32 | 9.94 | 5.32 | 1.4% |
| 1896 | 3.90 | 6.53 | 11.48 | 6.21 | 1.5% |
| 1901 | n.a. | n.a. | n.a. | n.a. | 1.6% |
| 1906 | 5.29 | 7.66 | 10.47 | 7.31 | 1.6% |
| 1911 | 5.85 | 7.63 | 11.94 | 8.34 | 1.9% |
| 1916 | 6.59 | 7.66 | 14.56 | 9.98 | 2.4% |
| 1921 | 9.03 | 10.31 | 18.28 | 13.23 | 3.4% |
| 1926 | 11.27 | 12.79 | 20.11 | 15.42 | 3.6% |
| 1931 | 15.32 | 18.14 | 28.52 | 21.99 | 4.0% |
| 1936 | 12.17 | 15.85 | 25.60 | 19.07 | 4.0% |
| 1941 | 9.83 | 12.29 | 19.14 | 14.63 | 3.8% |

Source: Tassonyi (2007)

Combining the revenue and assessment data, total local property taxes as a percentage of assessed values rose from about 1.3 percent in 1886 to 1.9 percent in 1911 percent, and then rose more sharply to a peak of 4 percent in the early 1930s before declining slightly (see Table 2).

While we have not (as yet) calculated this figure for the whole period considered here, earlier work found that in the 1969-78 period, local property taxes as a share of assessed values remained close to its level 30 years earlier, that is, 4 percent (Bird and Slack 1981, 475). Unfortunately, we have no information on market values or household incomes for the earlier period. On the whole, however, through depression, war, and post-war boom the story for the thirty years following the pre-war peak seems for local governments to have continued to be one of struggling to stay fiscally afloat since the GDP- elasticity of local property taxes was estimated to be only .87 for 1933-65 (Bird 1970, 291). Similarly, for Canada as whole, property taxes declined sharply over the 1926-1950 period, and then increased to 1970, before falling again in the next two decades as a share of GDP or, for that matter, personal disposable income (Bird and Slack 1993, 80). Although per capita taxes in real terms grew over the period, a 1998 estimate found that, on average, property taxes accounted for 1.2 percent of the estimated market value of homes in Ontario and about 3.2 percent of pre-tax income (Chawla and Wannell 2003).

## The Thirty-Year Struggle

Much of the thirty year period between 1967 and 1998 was taken up with renewed attempts to reform the property tax – a tax which, it will be recalled, was essentially established in its then-prevailing form in 1904. Could a tax adopted in an Ontario with a population of about 2 million, over half living in rural areas and with its largest urban area (Toronto) having only about 200,000 people still be appropriate for a province which in 1970 already had a population of 7.7 million, 82 percent of whom lived in urban areas, and whose metropolitan city and environs had grown to 2.9 million let alone by 1996, when the Ontario population was almost 11 million of which 83 percent was urban and the metropolitan city and environs had 4.6 million people.

## The Smith Committee

The modern history of property tax reform in Ontario begins with the report of the Smith Committee in 1967 (Ontario Committee 1967).[13] This committee, like similar committees in other provinces at that time, condemned the property tax for being regressive (borne relatively more heavily by low-income households than high-income households) and for being inequitably administered (properties of similar value were not assessed the same amount). Finding that over half of assessments deviated by more than 20 percent from city-wide averages, the Committee found that this was “a degree of inaccuracy that deserved public censure” (Ontario Committee 1967, 255) and recommended both that real property should be assessed at "actual" value and that the Province should play an increased role in assessing real property.[14]

In response, the long-standing Conservative provincial government took over the assessment function from municipalities in 1970 and made a commitment to adopt full market value assessment as the base for property taxes throughout the province. The change involved in market value assessment implied tax shifts from some sections of the community to others. Since those on the losing side are most likely to be unhappy, any government that proposes to carry out such a policy change is not going to find it easy and will likely have to compromise and negotiate with the affected groups. Ontario's experience over the last 30 years certainly confirms this hypothesis.

Following several postponements of the scheduled date for the introduction of province-wide market value assessment, the 1976 provincial budget set out a series of reforms to the tax system that were required before market value assessment could be introduced: assessment reform could not be implemented without tax policy reform. In particular, residential property values had been increasing more rapidly than non-residential property values and, as a result, the frozen assessment meant that residential assessments were further from market value than non-residential assessments. Moreover, the split mill rate in effect at the time meant that the mill rate on residential assessment for municipal purposes was legislated to be 85 percent of the mill rate on commercial and industrial assessment; for education purposes, it was legislated to be 90 percent of the commercial and industrial rate. A move to market value, without any change in tax policy, would thus result in a substantial – and politically dangerous -- shift in taxes on to residential properties.

The proposed reforms included taxing residences on 50 percent of market value and other properties on 100 percent to alleviate the anticipated shift in taxes towards residential properties. Other reform proposals included limits to exemptions, phase-ins and other tax changes. The 1976 provincial budget also recommended the move to a uniform business tax. As noted earlier, the business occupancy tax was applied at different rates for different types of businesses.[15]

**The Blair Commission**

After the release of the 1976 budget, the provincial government appointed yet another Commission (the Blair Commission) to consider the property tax proposals in more detail. The Blair Commission reported in 1977 and supported the main recommendations of the 1976 budget (Ontario 1977). The government's response was to issue yet another set of proposals in 1978 known as the 'Alternative System', which – in a manner reminiscent of events at the turn of the 20th century - removed the idea of a uniform business tax in favour of maintaining the long-standing differentiated levy and also made some other changes in the 1976 budget proposals.

Yet another committee was then established in 1978 to consider these proposals. The report of the Provincial-Local Government Committee (1978) supported many aspects of the Alternative System but suggested two major changes. First, multiple residences (7+ units) were to be taxed on 75 percent of market value. [16] This move would have reduced the shift from apartments on to single-family homes. Second, Metro Toronto[17] was to be allowed to deviate for up to three years from the general 50 and 75 percent proposed for residential and multi-residential properties -- for example to 45 and 80 percent. This change was designed to cushion the impact on Metro Toronto, where apartments were even more over-assessed than in other municipalities.[18] The effect of these recommendations was obviously to reduce substantially the tax shift from assessment reform, especially on single-family residences whose owners are much more likely to vote in local elections than are tenants.

Nonetheless, despite all these efforts to cushion the impact of market value assessment, in 1978 the Province announced that no property tax reform would be implemented. Later that year, the Minister of Revenue said that municipalities could, at their option, apply to the Province under then section 86 of the Assessment Act for reassessment *within* classes of property (such as single-family homes, apartments, commercial properties etc.). In other words, they could apply to reduce the inequities within classes of property without addressing the inequities between classes of property. Many municipalities across the province exercised this option. Conspicuously, Metro Toronto did not.

Since the new system was voluntary, not all municipalities (including the largest, Toronto), implemented market value assessment. As a result, assessments for similar properties differed within municipalities, generally with newer properties having higher assessments; assessments for similar properties varied among municipalities and relative tax burdens were higher on commercial, industrial and multi-residential properties compared to residential properties. Despite the provincial takeover of assessment policy, assessment reform was piecemeal throughout the 1980s and 1990s. Until 1997, municipalities could chose between two methods of updating their assessment bases, full market value or factored value. The latter corrected inequities within a class of property but left the class tax distribution unchanged. Many large municipalities chose not to implement any updating of the assessment base.

When a new Liberal government came in a few years later, in 1985, it once again took on the challenge of property tax reform, commissioning David Goyette to make recommendations on assessment and property taxation. His report was appropriately titled 'Taxing Matters: An Assessment of the Practice of Property Taxation in Ontario.' (Ontario 1985) The result, unsurprisingly, was the usual property tax two-step: first, the report recommended market value assessment (taxable assessments would be at 100 percent of market value) and, second, the government backed away from implementing the recommendations (Slack 2002).

**The Last Hurrah(s)**

In 1991, yet another new government (this time from the NDP party) commissioned yet another study to review property taxation (as well as other forms of taxation) in Ontario. The

Ontario Fair Tax Commission made several recommendations on property taxation and municipal and education funding in 1993. In terms reminiscent of the Smith Committee, its report noted that “the assessment system is in a shambles” (Ontario Fair Tax Commission 1993, 80). Its solution, however, in contrast to earlier studies, was to recommend unit value assessment - a relatively new concept in Ontario. Unit value assessment focuses on the size of the property and not on variables such as location.[19] However, this novel recommendation met the usual fate: it too was not implemented.

Towards the end of its mandate, the NDP government established the Greater Toronto Area (GTA) Task Force. Problems with the property tax in Toronto had become urgent by this time: assessment appeals were eroding Metro Toronto's tax base and there was a feeling that businesses were leaving Metro because of high property taxes.[20] To the extent that appeals are successful, the assessment base is eroded and all taxpayers face higher tax rates. Higher taxes on businesses in Toronto relative to the rest of the Greater Toronto Area (GTA) provided an incentive for businesses to leave Toronto, creating what the Board of Trade of Metropolitan Toronto (1994) called the "hole in the doughnut." The GTA Task Force, which continued its work under the new Conservative government, recommended 'actual value’ assessment. (Greater Toronto Area Task Force 1996)

In response to the Task Force report, the government established its own panel, the Who Does What Panel, to address both issues in property taxation and the disentanglement of provincial-local responsibilities. The Panel recommended the implementation of a uniform value-based assessment system province-wide (which it called “current value” assessment) with variable tax rates by type of property to be set by municipalities (Who Does What Panel 1996).

## One Step Forward, Many Steps Back?

A system along these lines (uniform market value province-wide with variable tax rates) was, finally, implemented in 1998. Since then, however, the tale has continued to unfold and to become ever more tangled and convoluted.

**The Big Reassessment**

In January 1998, a uniform assessment system based on "current value" (which is simply another name for market value) was implemented province-wide.[21] All properties were to be assessed at their current value (CVA), defined in the *Assessment Act* [R.S.O. 1990, Chapter A.31, sec.1] in the conventional words -- "the amount of money the fee simple, if unencumbered, would realize if sold at arm's length by a willing seller to a willing buyer."

In the same year, the assessment function was moved from the provincial government to the Ontario Property Assessment Corporation (OPAC), a not-for-profit corporation established by statute (*Ontario Property Assessment Corporation Act, 1997*). Every municipality in Ontario is a member of this corporation, which was re-named the Municipal Property Assessment Corporation (MPAC) in 2001 (and the name of the Act was correspondingly changed). The corporation is governed by a Board of Directors comprising five 'taxpayer representatives', eight municipal representatives, and two provincial representatives, all of whom are appointed by the provincial government – in the case of the municipal representatives from a list of 24 submitted by the Association of Municipalities of Ontario (AMO). The role of MPAC is to determine the assessed values of properties (pursuant to the *Assessment Act*), to classify properties according to the regulations, to determine which properties are entitled to be exempt from taxation, to prepare and deliver an annual assessment roll to municipalities, and to defend assessment appeals.

For the years 1998-2000, every property was assessed as of the valuation date of June 30, 1996. The same valuation date was used for three years initially to get the new system going. For 2001 and 2002, values were assessed as at June 30, 1999 as the province phased in annual assessments. In 2003, values were assessed as at June 30, 2001. In 2004, 'current values' were set at those assessed as of June 30, 2003. Originally, it had been proposed that, starting in 2005, assessments would be based on average values from successive tax years (referred to as "rolling averages"). For 2005, a two-year average was to be employed (the average of the current value for the tax year plus the current value for the previous tax year). For 2006 and subsequent years, property assessments were to be based on three-year averages (the average of the current value for the tax year plus the current value for each of the two preceding tax years). In fact, as noted below, none of this averaging has taken place, and values for 2007 and 2008 have been set at those assessed as of January 1, 2005. Moreover, the law (*Assessment Act*, sec. 19.2) currently specifies that the value for the four years 2009-2012 will be that of January 1, 2008, and that it will thereafter be adjusted every four years to be the value as of January 1 in the year preceding the four-year period. Table 3 provides a summary of the assessment update cycle.

Table 3: Assessment Update Cycle

| Taxation Year(s) | Valuation Date |
|---|---|
| 1998, 1999, 2000 | June 30, 1996 |
| 2001, 2002 | June 30, 1999 |
| 2003 | June 30, 2001 |
| 2004, 2005 | June 30, 2003 |
| 2006, 2007, 2008 | January 1, 2005 |
| 2009 | January 1, 2008 |

Source: Municipal Property Assessment Corporation, 2006 Annual Report

**A 'Classified' Tax**

Although municipalities are free to set their own tax rates, the 1998 Assessment Act established a 'classified' property tax system in the traditional sense that different rates may be applied to different classes of property. Municipalities in Ontario may levy variable tax rates for seven different classes of property established by the province: residential, multi-residential, commercial, industrial, pipelines, farms, and managed forests. In addition, municipalities may choose to adopt optional classes (also established by the province), including new multi-residential, office buildings, shopping centers, parking lots, large industrial properties, professional sports facilities, and resort condominiums.[22]

Rate reductions are specified in the act for certain sub-classes: vacant commercial (35 percent reduction), vacant industrial (30 percent reduction), farmland pending development, and, in the City of Toronto, certain theatres. The tax rate on farms and managed forests is legislated to be 25 percent of the residential tax rate.[23] Farmland is assessed at its value in current use and the tax rate is legislated to be 25 percent of the residential rate. Tax rates on farmland pending development can be phased in over stages. The triggers for tax increases are: when the land is used solely for farm purposes but has been registered for subdivision and when the land is used solely for farm purposes but a building permit has been issued. In addition, the commercial and industrial classes can be divided into three bands according to value, with graduated tax rates applied to each band. In total, there are 36 separate property classes and sub-classes that may be specified (see Appendix B for a list of classes).

### Major Changes in Education Funding

Another change that took place in 1998 was the uploading of elementary and secondary education to the province. The delivery of elementary and secondary education in Ontario is the responsibility of public and separate school boards. Prior to 1998, education funding was based on property taxes (set by the school boards and collected by municipalities) and provincial grants. In 1998, the Province took over complete responsibility for education finance including setting local tax rates. The Province sets the property tax rates for education and the level of funding for education. The Province sets a uniform tax rate on residential property (including multi-residential properties) throughout the province. Business education property tax rates (BET), however, vary by class of property (commercial, industrial, pipelines) and by upper-tier or single-tier municipality.[24] Where these rates are above the provincial average, a rate reduction program has been in effect since 1998, using provincial funds. The amount of the provincial transfer is the difference between a school board's entitlement under the provincial grant program (known as the student focused-funding model) and the revenues received from the municipalities' collection of education property taxes.

The education property tax system is administered by lower-tier and single-tier municipalities as part of their tax administration system. Thus, billing and collection occurs in the context of the municipal property tax bills received by taxpayers. Municipalities are obligated to remit the taxes collected for education purposes to the local school boards.

### The Immediate Results

Although the property tax is classified, it may be argued, as indeed it has been by MPAC (in its earlier incarnation as OPAC, 2000) that at least the assessment inequities of the pre-existing system have been corrected. At least one study has argued that even this has not been achieved. Thrall (1979) had demonstrated that, under the earlier system, assessed values did not reflect market values evenly in Hamilton (a medium-sized city near Toronto): some types of properties and some neighbourhoods were overtaxed and others were undertaxed. Harris and Lehman (2001) undertook a similar study for the same city to test the 'equity' of the new system. Their basic finding was that the patterns found for 1976 by Thrall (1979) were essentially unchanged in the initial 1996 assessments under the new system. If there had been inequity before; it still existed and may indeed even have increased in some respects. In particular, Harris and Lehman (2001) argue that the regressivity of the property tax, viewed as a tax on housing (see e.g. Chawla and Wannell 2003)[25] is accentuated by the apparent tendency of the new assessment system, like the old but even – so they argue – more so, to over-assess lower-valued properties. MPAC experts were quick to refute the conclusions drawn from their study, essentially on the grounds that their market value data was seriously incomplete and biased, an argument that seems correct to some (unknown) extent.[26] Interestingly, however, while Moore (2002, 365) refers to an "internal [MPAC] ratio study for the City of Hamilton [that] produced results that are in direct opposition to those produced in the study by Professors [sic] Harris and Lehman" he provides neither any details on the results of this 'internal' study nor any information on how this study was conducted. Unfortunately, as we discuss later, the operations of MPAC to this day continue to be conducted in a similar opaque rather than transparent way. It is thus not surprising, as the recent report by the provincial Ombudsman (see below) indicates, that no one out there seems ready to concede that MPAC assessments of their properties reflect the outcome of an expert and unbiased assessment process.

Of course, any change to a uniform province-wide assessment system by itself would have resulted in large shifts in tax burdens within and between classes of property. For this reason, tax policy changes were introduced along with assessment reform. For example, the business occupancy tax – essentially a rate varying by industry applied to assessed value in addition to the normal property tax – which had been established in 1904, was abolished in 1998 as part of the property tax reform. Indeed, in total the provincial government introduced seven pieces of legislation affecting local property taxes between 1998 and 2001. These reforms as well as those that occurred after 2001 are summarized in Table 4.

Table 4: Summary of the Highlights of Property Tax Reform, 1998-2007

| Date | Property Class | Measure | Legislation |
|---|---|---|---|
| 1998 | All | Current value assessment; property classification system; municipalities given authority to levy variable mill rates; phase-ins; tax mitigation measures for seniors and disabled | *Fair Municipal Finance Act, 1997* (Bill 106); *Fair Municipal Finance Act, 1997* (No.2) (Bill 149) amending the *Assessment Act* and the *Municipal Act* |
| 1998 | All | Transfer of responsibility for rate setting to provincial government for education | *Education Quality Improvement Act, 1997* amending the *Education Act* |
| 1998 | All | Creation of Ontario Property Assessment Corporation (OPAC) to conduct assessments on behalf of municipalities | *Ontario Property Assessment Corporation Act, 1997* (Bill 164, Schedule G |
| 1998 | Multi-residential, commercial, and industrial | Optional capping (at 2.5%) of property tax increases for businesses for 1998, 1999, and 2000 | *Small Business and Charities Protection Act, 1998* (Bill 16) amending the *Assessment Act* and the *Municipal Act* |
| 1998 | Multi-residential, commercial, and industrial | Mandatory provision of tax rebates to charities | *Small Business and Charities Protection Act, 1998* (Bill 16) amending the *Assessment Act* and the *Municipal Act* |
| 1998 | Multi-residential, commercial, and industrial | Mandatory capping on property tax increases for 1998, 1999, 2000; use of "frozen assessment listing" | Fairness for *Property Taxpayers Act, 1998* (Bill 79) amending the *Assessment Act* and the *Municipal Act* |
| 1999 | Multi-residential, commercial, and industrial | Newly-constructed properties to be taxed at a level of assessment no higher than that of comparable properties in the vicinity | *Tax Credits to Create Jobs Act, 1999* (Bill 14) amending the *Assessment Act* and the *Municipal Act* |
| 2000 | Multi-residential, commercial, and industrial | Mandatory limits on reassessment-related property tax increases for 2001 and future years; restriction on municipal levy increases where tax ratios above defined thresholds; comparable tax levels for new construction and other eligible properties | *Continued Protection for Property Taxpayers Act, 2000* (Bill 140) amending the *Assessment Act* and the *Municipal Act* |

| | | | |
|---|---|---|---|
| 2001 | All | Change name of OPAC to Municipal Property Assessment Corporation | Amendments to the *Municipal Property Assessment Corporation Act, 1997* |
| 2004 | All | Defer implementation of assessment averaging | Amendments to the *Assessment Act, Municipal Act, 2001* |
| 2005 | All | Beginning in 2006 tax year, assessment value date moved up from June 30 to January 1; reassessment for 2005 was cancelled | Amendments to the *Assessment Act* |
| 2005 | Multi-residential, commercial, and industrial | Option to increase annual cap up to 10% of previous year's taxes or minimum annual increase of up to 5% of CVA taxes; could phase out new construction treatment; option of graduated rates for optional classes | Amendments to the *Municipal Act, 2001* |
| 2006 | All | Assessments for 2006 and 2007 frozen at 2005 level | Amendments to the *Assessment Act* |
| 2007 | All | Move to four-year assessment cycle | Amendments to the *Assessment Act* |
| 2007 | Residential, farm, managed forests | Mandatory four-year phase-in of assessment increases | Amendments to the *Assessment Act* |
| 2007 | Residential | Enhance property and sales tax credits for seniors | In progress |
| 2007 | Commercial, and industrial | Reduce provincial business education tax | Annual regulations under the *Education Act* |

**Dealing with Reactions**

Many of these changes reflect the efforts of politicians to deal with public concerns by softening the impact of the 1998 system in various ways. For example, variable tax rates were introduced to allow municipalities to shift tax burdens among property classes although the amount of inter-class shifting was restricted.

As a starting point in 1998, the Province identified the existing (pre-reform) municipal tax burdens in each municipality. Based on the new 1998 assessment and 1997 taxes, relative municipal tax burdens were expressed in terms of transition ratios which compared the notional effective tax rate of a property class (e.g. commercial) to the effective tax rate of the residential property class. The residential class was deemed to have a transition ratio of 1.0.

To ensure that the gap in effective tax rates was not widened further, the Province prescribed "ranges of fairness" for each property class. Ranges of fairness illustrate target levels of municipal taxation, expressed as tax ratios (the ratio of the effective tax rate for the property class relative to the effective tax rate for the residential class) for each property class. Table 5 shows the prescribed ranges of fairness.

**Table 5: Provincial Ranges of Fairness, Ontario**

| **Property Class** | **Allowable Range of Fairness** |
|---|---:|
| Multi-residential | 1.0 - 1.1 |
| New multi-residential | 1.0 - 1.1 |
| Commercial | 0.6 - 1.1 |
| Office building | 0.6 - 1.1 |
| Shopping centre | 0.6 – 1.1 |
| Parking lots and vacant land | 0.6 – 1.1 |
| Professional sports facility | 0.001 – 1.1 |
| Industrial | 0.6 - 1.1 |
| Large industrial | 0.6 – 1.1 |
| Pipelines | 0.6 – 0.7 |

Municipalities can set a class tax ratio to maintain the transition ratio or to move towards the range of fairness (but not away from it), and they can vary a tax ratio within the range of fairness. For example, if the calculated transition ratio for multi-residential properties was 4.1, a municipality could reduce it to 4.0 or below or maintain it at 4.1, but it could not increase it (and thus worsen inter-class inequities).[27] Once the tax ratio of a property class reaches the target range, the municipality can adjust it up or down within the range.

Most municipalities adopted the prescribed transition ratios in 1998; others chose to move ratios towards the target ranges. Table 6 compares the actual tax ratios adopted by selected municipalities in Ontario in 2002 with the regulated tax ratios prescribed in 1998. Most municipalities were at or below the prescribed tax ratios. Toronto was considerably below the regulated levels when compared to other municipalities because residential property values increased more quickly than non-residential values in Toronto than in other parts of the province. In some municipalities, such as Durham Region, a deliberate effort was made to shift taxes away from some of the non-residential property classes.

In addition to variable tax rates, the Province also legislated both phase-in provisions for assessment-related tax increases and tax deferrals in order to deal with shifts that would occur within classes of property, especially within the residential property class. Municipalities, at their option, could apply a phase-in for up to eight years for assessment-related tax changes. Inter-class subsidization was not permitted; in other words, the reduced tax revenues from phased-in properties had to borne by a reduction in tax decreases for those whose property taxes fell in each class. Tax decreases in the commercial class, for example, could not be used to subsidize tax increases in the residential class. Different schemes can apply to different classes, and different phase-in periods could be used for decreases and increases. This is not a simple system.

Even with the initial tax policy reforms and phase-in mechanisms, there were still large shifts in tax burdens among property classes. In particular, the tax burden on small retail commercial properties in Toronto increased relative to large office towers in part because of a decline in office markets in June 1996 (the original valuation date for the property tax under the new system). To reduce this shift to small commercial properties, as already mentioned the provincial government introduced optional classes for office towers, shopping centres, parking lots, and large industrial properties.[28] Moreover, it introduced a system of optional ‘capping’ under which municipalities could limit tax increases on commercial, industrial, and multi-

Table 6: A Comparison of Regulated and Actual Tax Ratios,
Selected Ontario Municipalities

| Municipality | 1998 Regulated Tax Ratios | | | | | | |
|---|---|---|---|---|---|---|---|
| | Multi-Residential | Commercial | Office Building | Parking Lot | Shopping Centre | Industrial | Large Industrial |
| **City of Toronto** | 5.2355 | 4.2759 | | | | 5.9685 | |
| **Durham Region** | 2.7103 | 1.4819 | 2.2960 | | 1.2078 | 2.0907 | 3.8036 |
| **Halton Region** | 2.4439 | 1.4565 | | | | 2.3599 | |
| **Peel Region** | 1.7336 | 1.2971 | | | | 1.5986 | |
| **York Region** | 2.0875 | 1.1190 | | | | 1.3427 | |
| **Niagara Region** | 2.5568 | 1.6464 | | | | 3.6362 | 4.1880 |
| **Waterloo Region** | 3.2146 | 2.0148 | | | | 3.2175 | |
| **Oxford County** | 2.8392 | 1.9018 | | | | 2.9098 | 3.4636 |
| **City of Ottawa** | 2.3359 | 1.9577 | 2.3659 | 1.2829 | 1.6285 | 2.2439 | 1.9269 |
| **City of Greater Sudbury** | 1.9570 | 1.6614 | | | | 2.4500 | 2.7560 |
| **City of Windsor** | 2.5202 | 1.9740 | 2.0071 | 1.0397 | 2.0269 | 2.8923 | 4.1218 |
| **City of Kingston** | 2.6526 | 1.6822 | | | | 2.5702 | |
| **City of London** | 2.3852 | 1.9136 | 2.2810 | | 1.6340 | 2.7633 | 3.1961 |
| **City of Hamilton** | 3.0614 | 2.2764 | | 1.8967 | 2.2426 | 3.9654 | 4.717 |
| **City of Thunder Bay** | 2.9039 | 2.4450 | 2.5823 | 1.4939 | 2.2136 | 3.2301 | 3.4718 |
| **Municipality** | **2002 Adopted Tax Ratios** | | | | | | |
| | Multi-Residential | Commercial | Office Building | Parking Lot | Shopping Centre | Industrial | Large Industrial |
| **City of Toronto** | 4.1700 | 3.8000 | | | | 5.3000 | |
| **Durham Region** | 2.4000 | 1.4819 | 1.4819 | | 1.3300 | 2.2598 | 2.9000 |
| **Halton Region** | 2.2619 | 1.4565 | | | | 2.3599 | |
| **Peel Region** | 1.7336 | 1.2971 | | | | 1.5986 | |
| **York Region** | 1.3000 | 1.1000 | | | | 1.3000 | |
| **Niagara Region** | 2.0000 | 1.6147 | | | | 3.3648 | 3.7052 |
| **Waterloo Region** | 2.7400 | 1.9800 | | | | 2.6300 | |
| **Oxford County** | 2.7400 | 1.9018 | | | | 2.8219 | 3.3667 |
| **City of Ottawa** | 2.1780 | 1.9288 | 2.3309 | | 1.6044 | 2.2439 | 1.9269 |
| **City of Greater Sudbury** | 1.9570 | 1.6614 | | | | 2.4500 | 2.7560 |
| **City of Windsor** | 2.5202 | 1.9740 | 2.0071 | | 2.0269 | 2.7228 | 3.8803 |
| **City of Kingston** | 2.6526 | 1.6616 | | | | 2.6299 | |
| **City of London** | 2.1077 | 1.8808 | | | | 2.6300 | |
| **City of Hamilton** | 2.8326 | 2.2420 | | 2.2420 | | 3.5621 | 4.1770 |
| **City of Thunder Bay** | 2.5400 | 2.3500 | 2.4800 | | 2.1300 | 3.1000 | 3.3300 |

Source: Ontario Ministry of Finance and OPTA database residential properties to 2.5 percent each year for three years (1998, 1999, and 2000). In other words, the property tax could not increase more than 2.5 percent on properties in any of these classes over what the tax had been prior to reform. All or part of the forgone revenues from capping tax increases was to be recovered through “clawbacks” – a reduction in the property tax decreases for other properties.

Initially, only Toronto chose the 2.5 percent capping option. When it became clear that there were large tax increases on small commercial properties in other municipalities in Ontario, the provincial government provided for a mandatory restriction on property tax increases on commercial and industrial properties to 10 percent in 1998, an additional 5 percent in 1999, and an additional 5 percent in 2000. Although these limits were not optional, municipalities could decide how to achieve the 10-5-5 target – through phase-ins, capping, or some other method.[29] In addition, all or part of the tax revenue forgone by a municipality as a result of these limits could be recovered by limiting or “clawing back” the tax decreases of other properties.

Starting in the 2000 taxation year, different capping rules were imposed with respect to commercial, industrial, or multi-residential properties that undergo a physical change (new construction) or a change in classification. In the first year of the change, the taxes were based on the lower of the property’s CVA or a downward adjustment of the CVA to reflect the average level of taxes of up to six similar properties in the vicinity. In subsequent years, the ordinary rules were to apply.

Essentially, the result of capping was to freeze the assessment roll at 1997 values for many properties. Municipalities used the so-called ‘frozen assessment listing’ (which contained property-specific information for the 1997 tax year) as the basis for calculating and billing taxes under the caps in 1998, 1999 and 2000. The new assessment roll was not used for multi-residential, commercial, or industrial properties. Capping also meant that no efforts were made to remove or even reduce the inequities in property tax burdens within these important property classes.

Dissatisfaction with the 10-5-5 limits based on the entrenched inequities resulting from the use of the frozen assessment listing (with the strongest views being expressed by property owners expecting tax relief) led to a significant change in the capping system in 2001. In particular, the use of the frozen assessment listing was discontinued. Henceforth, the annual taxes of a property in the capped classes were based on 5 percent of the annualized taxes of the previous year (for properties that would otherwise experience a reassessment-related tax increase) plus an adjustment for municipal levy increases.

Starting in 2001, however, municipal levy increases (i.e., year-over-year municipal tax increases) were not permitted on any property class if a municipality's tax ratio for the class exceeded the provincially prescribed "threshold ratio" (which is the provincial average ratio). The tax burden on any class could only be increased when the ratio moved below the threshold. The following threshold ratios were prescribed: commercial --1.98; industrial -- 2.63; and multi-residential -- 2.74. For municipalities with tax ratios above the threshold levels for these three property classes, any tax increase resulting from a budgetary increase had to be borne largely by residential property taxpayers. These ratios remain in effect (although, as noted below, with some changes in the rules).

Even after all these changes, issues continued to arise with respect to property taxation. The most important problems arose because residential property values increased more quickly than those of commercial properties in the large municipalities in the southern part of the province. When combined with the provincial restrictions on tax ratios, the result was a significant shift in taxes to the residential property tax base as a result of reassessment. In reaction, in 2004, the new Liberal provincial government made two important policy changes.

First, to address tax shifts due to reassessment, municipalities were permitted to increase the tax ratio of one or more business property classes away from the direction of the target ranges of tax ratios to the extent necessary to maintain the existing municipal tax burdens between the residential and business classes (that is, prevent a reassessment-related tax shift onto the residential property class). Ratios could be increased only to maintain revenue neutrality among classes and not to increase the tax burden on any class.

Second, municipalities with property classes subject to limits on their levy increases (that is, they were beyond the provincially prescribed threshold) were permitted to apply a municipal tax increase to those classes – although only up to the limit of half of any tax rate increase applied to the residential class.

Still other issues arose with respect to the program of capping and clawbacks, the future implementation of assessment averaging, the timeline of the assessment cycle, and the inability of municipalities to target tax relief to small business. Based on consultations with representatives from the municipal and business communities, further property tax changes were announced in the 2004 Budget.

**Nobody's Satisfied**

The 2004 taxation year was the first year that a reassessment was conducted using a valuation date of June 30 of the previous year. Those involved in the assessment process felt that an annual reassessment based on a June 30 valuation date did not give sufficient time for MPAC to assess all properties (approximately 4.3 million). Moreover, a valuation date of June 30 did not give municipalities sufficient time to analyze the reassessment data nor did it give taxpayers enough time to address their concerns prior to the appeal deadline. In response to these concerns, the province moved the valuation date up six months to January 1 of the preceding year, beginning with the 2006 taxation year. Supposedly to ease the transition to the new date, the reassessment scheduled for 2005 was cancelled, with the result that, as noted earlier, the valuation date for 2005 was June 30, 2003, the same date that was used for the 2004 taxation year.

Questions were also raised about averaging, with the result that in 2004 it was decided to defer its implementation to some future date to be determined by the province. The reasons given were that averaging would increase the complexity of the property tax system – one wonders if that were possible? --, would not enhance fairness to taxpayers, and would be redundant with existing property tax mitigation tools.

Capping was criticized because it embedded historical tax inequities, slowed the rate of progress to CVA, made the system too complex, and imposed administrative costs on municipalities. In response, new optional features were introduced starting in 2005 designed to accelerate the progress to CVA taxes and increase the number of properties paying taxes at the CVA level -- that is, the taxes they would pay if not subject to capping or clawbacks. Municipalities were given the choice of increasing the annual cap up to 10 percent of the previous year's taxes (in other words, they could choose a rate of increase anywhere between 5 and 10 percent) or implementing a minimum annual increase of up to 5 percent of CVA-level taxes. Municipalities were also allowed to move capped or clawed back properties directly to their CVA taxes if the taxes were within $250 of the properties' CVA taxes (or a lower threshold if they chose).

These options could be adopted on a class-by-class basis. For example, a municipality could cap the growth in taxes in the commercial class at 5 percent of last year's taxes, taxes in its multi-residential class at 10 percent of last year's taxes, and taxes in its industrial class at 5 percent of CVA-level taxes. Thresholds could also be different for different property classes. Capping decisions were to be made annually based on the impact of the current reassessment and past progress towards CVA taxes. Municipalities could also phase out the new construction treatment (introduced, as mentioned earlier, in 2000) by creating floors establishing a minimum percentage of CVA tax responsibility so that eligible properties would be taxed at up to 70 percent of CVA-level taxes in 2005, up to 80 percent in 2006, up to 90 percent in 2007, and up to 100 percent in 2008 and future years.

The concerns about targeting relief to small business were addressed by allowing municipalities to apply graduated tax rates to the optional property classes. Municipalities had been able to apply graduated tax rates to the commercial or industrial classes at the broad class level since 1998 but not to the optional property classes within those classes (such as commercial and industrial properties not categorized as office buildings, shopping centres, or large industrial properties).

### The Ombudsman Speaks

Most recently, after receiving complaints from 75 taxpayers about their assessments, the Ombudsman for Ontario undertook an investigation of MPAC in 2005.[30] His report addressed the transparency of the property assessment process and the integrity and efficiency of decision-making at MPAC. The 22 recommendations in the Ombudsman's 2006 report addressed three major areas of concern:

- Taxpayers had difficulty accessing the information needed to understand their assessments or to appeal them to the Assessment Review Board (ARB), an appeal tribunal that provides property owners with the opportunity for an independent review of their property classification or assessment.[31]
- In assessing a property, MPAC was said often to ignore the actual sale price of the property without providing any reason why the sale price did not adequately reflect the market value. It also downplayed the importance of recent sales of comparable properties. Moreover, MPAC did not give adequate respect to the decisions rendered by the ARB, believing that its mass appraisal techniques were superior to sales of comparable properties. Although MPAC is legally bound to accept ARB decisions for the tax year appealed, it often ignored those decisions in the next tax year, requiring taxpayers to launch another appeal.
- The onus of proof at an ARB hearing was (and still is) on the taxpayer to show that MPAC's assessment was wrong and not on MPAC to explain its assessment and show why it was right.

The Ombudsman's Report made a series of recommendations to address access to information. It recommended, for example, that MPAC provide information to taxpayers on their notice of assessment of the average increase in assessed value in the particular neighbourhood (rather than just the average for the municipality). The notice should also provide information on "comparable" property assessments – why they are desirable, how those comparables can be accessed, and the reliance of MPAC on the six comparables that it selects in the event of an appeal. In addition, the Ombudsman recommended that MPAC implement measures to increase access to information about its computerized appraisal processes and that it publishes its administrative procedures regarding assessments and inspections, disclosure of information, requests for reconsideration, and ARB appeals.

To address the second concern about the use of sale prices in the determination of the assessed value, the Ombudsman recommended that, when a property assessment is challenged based on an actual sale price proximate to the valuation date, MPAC should generally accept that sale as the best evidence of the property assessment. The actual sale price should also be an important factor in assessing the value of the property in future years. The Ombudsman also recommended that MPAC apply the ARB decisions on the value at specific valuation dates when carrying out assessments for future years that use the same date. He further recommended that MPAC also apply assessment reductions imposed by the ARB in arriving at future assessed values, unless the ARB decision is quashed or circumstances have changed.

With respect to the third concern about the onus of proof, the Ombudsman recommended that the onus in assessment matters before the ARB should be placed on MPAC to substantiate its assessments when they are challenged.

Following the Ombudsman's report, the provincial government froze assessments for 2006 and 2007 at the level used in 2005, ostensibly to give MPAC time to implement the Ombudsman's recommendations and improve the assessment process. Subsequently, continued concern about volatility in property prices (and in assessed values and taxes) led the province, in the 2007 Budget, to move to a four-year assessment cycle (instead of every year) beginning in the 2009 taxation year. Interestingly, since provincial elections are now also on a four-year cycle, the new the reassessments are scheduled to fall in the middle of that period. Additional important amendments to the *Assessment Act* in 2007 included a mandatory four-year phase-in of eligible increases in the assessment of residential, farm, and managed forest properties (or other classes prescribed by the province). On the other hand, assessment decreases are to be applied immediately. If the current value assessment increases as a result because of a general reassessment, CVA for tax purposes are to be reduced by 75 percent of the eligible increase in the first year, 50 percent in the second year, and 25 percent in the third year.

In addition, the 2007 Budget announced a plan to cut the provincial Business Education Taxes (BET) over seven years. High BET rates are to be lowered to a target maximum rate of 1.60 percent (a reduction of almost 14 percent in the current average BET rate of 1.85 percent). Moreover, the provincial Property and Sales Tax Credits for seniors were enhanced by increasing the senior couples' income threshold for these credits. Finally, in response to the Ombudsman's report, the province proposed to establish a two-stage assessment appeal process with standardized information disclosure protocols. The legislative dance around property tax reform thus continues unabated.

As yet, however, nothing has been done to unveil to the public, let alone the expert public, what exactly goes on within MPAC. The MPAC web page is certainly a vast improvement on the 'hermetic secrecy' (Bird and Slack 1978, 15) that once characterized the assessment process in Ontario. Reflecting in part the 'privatized' nature of the agency, however, it is still far from entirely clear when it comes to informing taxpayers just how the value of their property has been assessed, as we shall discuss in detail in other papers.

## Is It All Just Politics?

The property tax 'system' in Ontario (or any jurisdiction) consists of the relevant laws and regulations and how they are administered. How that system is constructed reflects the political institutions and interactions prevailing within and between the provincial and local sectors, and the perceptions of those involved with respect to the economic outcomes of property tax policies. The basic legal framework is exceptionally simple: as we have shown in detail, the province controls everything. To paraphrase a well-known expression: they say unto this one go, and he goeth; and to that one, come, and he cometh. And there has indeed been a considerable amount of coming and going with respect to the property tax although, as discussed, in many ways key aspects of the existing system have very long and deep roots in provincial history.

Of course, law is not simply directive; it is also reflective of the underlying configuration of interests, ideas, and institutions that lead to its enactment: all taxes are ultimately political, and none more so than the property tax. As Frisken (1991) discusses in detail, property tax reform in Ontario over the years shows in many ways the very real influence that local interests have played in shaping provincial policy. Nonetheless, it is equally clear from the preceding discussion that both in the past and in the future any significant reform in the property tax system requires not just the acquiescence but the active participation and indeed even the initiating move of the provincial government. Citizens and local governments may, like Glendower in Henry IV, Part 1, attempt to "call spirits from the vasty deep" to reform the property tax. Like Hotspur, however, we must reply: "And so can I, or so can any man; but will they come when you do call for them?" – unless, of course, the Provincial government allows them to do so.

Economics dictates that property taxes should be designed to meet a number of public finance principles such as equity and efficiency. The reality of how property taxes are implemented anywhere, however, is often much different than those principles would suggest. As Holcombe (1998, 359) notes, "tax policy is the product of political decision making, with economic analysis playing only a minor supporting role." Nowhere is this truer than with respect to the property tax, in large part because of the particular characteristics of that tax. Several characteristics of the property tax differentiate it from other taxes.[32]

To begin with, the property tax is a very visible tax. Unlike the income tax, the property tax is not withheld at source. Unlike the sales tax, it is not paid in small amounts with each daily purchase. Instead, the property tax generally has to be paid directly by taxpayers in periodic lump sum payments. This means that taxpayers tend often to be more aware of the property taxes they pay than they are of other taxes.[33] Naturally, they will usually oppose tax increases. On the other hand, since the property tax finances services which are also very visible, such as roads, garbage collection, and neighbourhood parks, they may be more amenable to tax increases when they see a strong connection between what they pay and what they get (Simonsen and Robbins 2003) than when it comes to increases in less 'connected' taxes like the income tax. Of course, visibility is clearly desirable from a decision-making perspective because it makes taxpayers aware of the costs of local public services. This awareness enhances accountability, which is good from both an economic (hard budget constraint) and political (democratic) perspective. It does not, however, make the property tax very popular. Visibility makes property taxes difficult to sell politically and even more difficult to increase or reform relative to other taxes. Indeed, the property tax is sometimes called the "most hated" tax (Brunori 2003, 7).

Another important characteristic of the property tax is that its base is relatively inelastic, and does not increase automatically over time. When, as in Ontario, property taxes are based on (some version of) market value assessment, property values generally respond more slowly to annual changes in economic activity than do incomes. This inelasticity is exacerbated when, as in once and, it seems, future Ontario, values for taxation purposes are not updated annually. In order to maintain property tax revenues in real terms (let alone to raise property tax revenues), it is necessary to increase the rate of the tax. As with visibility, inelasticity results in greater accountability because taxing authorities have to increase the tax rate to increase tax revenues but it also inevitably results in greater taxpayer resistance.

Most apropos to the present study, however, taxpayers also dislike the property tax because of the irreducibly arbitrary way in which it is administered. Other taxes (such as income and sales taxes) are based on flows – income or sales. Although the tax base may sometimes be the source of argument between the taxpayer and the tax authority, there is, in principle, a measurable economic activity on the basis of which the tax is levied. Property taxes, on the other hand, are generally based on stocks – asset values. Unless the asset subject to tax is sold (in an arm's length transaction by a willing buyer to a willing seller) in the tax period, someone has to determine the value that serves as the basis on which to assess the tax.

"Market value" systems, no matter how well run, are thus inherently and inevitably arguable – and often subject to legitimate appeal. Most owners are likely to feel that their property is (at least relative to their neighbour's property) overvalued. And, for all they – or, in many systems, anyone – may know, they could be right. Absent a current sale, in the end someone has to determine the tax base for the property tax in a way that is not true for any other significant tax.[34] It is not surprising that the results are often perceived to be unfair and arbitrary. Taxpayers' perceptions around the fairness of the tax (and how it is implemented) have an impact on the extent to which local governments can raise the tax.

The property tax is generally regarded as a good tax for local governments because property is immovable – it is unable to shift location in response to the tax and it cannot be hidden. Thus, it is difficult to evade the tax. Although a change in property tax may be capitalized into property values in a particular community, and in the long run tax differentials may affect where people locate, these effects are of a smaller magnitude than those that would occur with income and sales taxes at the local level. This characteristic of the property tax makes it somewhat easier to levy and collect than other taxes. On the other hand, the very fact that it is hard to dodge the tax may make people particularly resentful of it.[35]

Finally, it is often noted that property taxes are well suited to local governments because of the connection between many of the services typically funded at the local level and the benefit to property values. Residential property taxes, in particular, are appropriate to fund local government expenditures because they are borne by local residents who use local services. To the extent that this is the case, local property finance of local services will promote efficient public decisions since taxpayers will support those measures for which the benefits exceed the taxes. Both the benefits derived from local services (for example, roads, transit, schools) and the taxes used to finance these services are capitalized into property values. Since taxpayers are willing to pay more for better services and lower tax rates, either will result, over time, in higher property values.[36] On the other hand, if people are dissatisfied with the local services they receive – for example, they see more potholes in their street at the same time as their tax bill is rising – their acceptance of the tax will obviously decrease (even if the reduced road maintenance simply reflects the Baumol (1967) principle at work). In addition, the politics of the benefit-tax connection may, as we shall discuss elsewhere, be very different when it comes to the substantial portion of the tax base consisting of non-residential property.

All these points underline the highly political nature of property tax policy at the local level. In the Ontario situation, the combination of two important realities has also made this issue highly salient at the provincial level. First, since half or more of the property tax collected by any municipality reflects decisions made at higher (regional or provincial) levels of government, and often related in no visible or accountable way to matching benefits to the community, one of the key arguments for local property taxation has been – indeed, has always been since at least 1850 – attenuated. Second, the many actions of the provincial government, especially since provincial assumption of assessment in 1970 and the explicit linkage of property and provincial income taxes later in that decade, but even more so with the almost annual post-1998 chopping and changing have made it abundantly clear to all that it is the province, not the local government, that has both the first and the last say when it comes to property taxes. In Ontario, property tax policy is thus pre-eminently a provincial rather than a municipal matter not just by law but more importantly by repeated provincial assertions of its controlling role down to all but the very finest details.

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## Appendix A: Ontario Municipal Structure

The current population of Ontario is 12 million and there are 445 municipalities which include cities, towns, townships, and villages. Where there is only one level of municipal government in an area, it is called a “single tier” municipality. The largest city in Ontario, Toronto with 2.5 million people, is now a single tier municipality. The two-tiers of metropolitan government were consolidated in Toronto in 1998.

In some parts of the province, there are two tiers of local government. The “upper tier” may be a region or county. Urban areas are organized in the regional system; rural areas are organized in the county system. A county or regional government is a federation of the local municipalities within its boundaries. The "lower tier" municipalities are cities, towns, townships, and villages. There are also a number of “separated” towns and cities in Ontario which are geographically part of a county but do not form part of county.

Regional councils have considerable authority in areas such as policing, social services, public health, solid waste disposal, water and sewer treatment and capital borrowing. Lower-tier municipalities tend to have responsibility for fire protection, parks and recreation, libraries, licensing, and tax collection. The powers available to county governments are more limited than those of regions. County councils have responsibility for county roads, homes for the aged, and welfare (although in some counties, some welfare is administered by the lower-tier municipalities).

The government structure in Northern Ontario, which is much more sparsely populated than Southern Ontario, includes cities and towns, as well as one district and one regional municipality. There are also administrative ways of providing services to huge areas of land that have very few people in what are called "unincorporated" areas of Northern Ontario. District Social Service Administration Boards, for example, are a vehicle for delivering social services to Northern residents.

## Appendix B: Property Classes and Sub-Classes

1. Residential
2. Residential Farmland Awaiting Development Phase 1
3. Residential Farmland Awaiting Development Phase 2
4. Resort Condominiums
5. Multi-Residential Occupied
6. Multi-Residential Farmland Awaiting Development Phase 1
7. New Multi-Residential
8. Commercial Occupied
9. Commercial Excess Land
10. Commercial Vacant Land
11. Commercial Farmland Awaiting Development Phase 1
12. Commercial Farmland Awaiting Development Phase 2
13. Office Buildings
14. Office Buildings Excess Land
15. Office Building Vacant Land
16. Shopping Centres
17. Shopping Centres Excess Land
18. Shopping Centres Vacant Land
19. Parking Lots and Vacant Land
20. Parking Lots and Vacant Excess Land
21. Professional Sports Facilities
22. Professional Sports Facilities, Excess Land
23. Professional Sports Facilities, Vacant Land
24. Industrial Occupied
25. Industrial Excess Land
26. Industrial Vacant Land
27. Industrial Farmland Awaiting Development Phase 1
28. Industrial Farmland Awaiting Development Phase 2
29. Large Industrial
30. Large Industrial Excess Land
31. Large Industrial Vacant Land
32. Pipelines
33. Farmlands
34. Managed Forests
35. Railway Rights of Way
36. Hydro Rights of Way

## Endnotes

[1] In 2005, the property tax accounted for 48 percent of municipal revenues, on average, province-wide. The remaining sources of municipal revenue are user fees (20 percent), intergovernmental transfers (20 percent), and other miscellaneous revenues (12 percent). With the exception of the City of Toronto which can levy some additional taxes (but not income, sales, fuel, or hotel taxes), municipalities in Ontario do not have access to other sources of tax revenue.

[2] Formal local government was established in part as a result of the 1839 Durham report into the popular uprising of 1837 which found that the lack of municipal government was one of the 'main causes of failure of representative government and of the bad administration of the country' (quoted in Perry 1955, 33).

[3] Of course, nothing is ever this simple in the world of Ontario property taxation: of the 46 percent that goes to the Region, 51 percent goes to a so-called 'Social Pooling Costs' levy that is shared throughout the Greater Toronto Area (GTA) while the 26 percent to education, as we note later, now goes directly to the provincial government. The 2007 Ontario Budget announced a seven-year phase-out of the GTA pooling arrangements, beginning this year.

[4] According to the Ontario Committee (1967, 30), forty-two of the sixty-nine sections of the 1843 Bill were copied directly.

[5] The estimated earnings per worker for an industrial worker in Ontario in 1870 were about $245. Drummond (1987, 427)

[6] As proposed by Commissions in 1888 and 1889, an 1890 law allowed municipalities to replace the personal property tax – by now essentially a tax on inventories – by a business tax based on annual rental value at a rate of 7.5 percent (with rental value being set as 7 percent of assessed (capital) value), but no one appears to have done so (Perry 1955, 84).

[7] It would appear that neither equity nor complications were the principal reasons for this outcome but rather expediency. As the Ontario Committee (1967, 38-39) puts it: "Rather than accept the value of business and urban residential premises as an appropriate measure for a basic amount of tax, the Select Committee [of the provincial legislature] endeavoured to relate the new tax to the old by setting differing percentages by class of business, with the intention of producing about the same revenues as the personal property tax had done."

[8] Levine (1987) provides an interesting analysis of discussions of property and land taxes in government reports and Toronto newspapers in the 1880-1920 period, arguing that what was at issue was mainly a political struggle between the dominant mercantile group and the rising rentiers and bourgeoisie of the growing city. This theme is developed further in Levine (1993), which provides a similarly interesting review of contemporary discussion of the single tax in a period that saw several avowed Single Taxers elected to Toronto's council. Although the final outcome of this movement was a limited success, when the Ontario legislature passed local

option legislation in 1920 permitting site value taxation, no municipality appears to have seized the chance before the option was removed in 1924 (Finnis 1972, 56), so this side path will be followed no further here. There was, however, one interesting anomaly that arose from the Single Tax era that perhaps deserves mention: in 1919 municipalities were permitted to use a partial graded exemption for dwellings assessed under $4000 in assessed value: only Toronto and one other municipality (that is now part of Toronto) took advantage of this legislation, which was presumably justified as a ‘veteran’s benefit’. The partial exemption was applied to the assessed value of the dwelling but not to the value of the site or other type of building or structure on the land. The results were still visible with respect to as many as 37,000 properties on the Toronto assessment roll in 1977 (Ontario 1977, 26). The partial graded exemption remained until the 1998 reforms when it was revoked.

[9] From the 1980s on, there were five business assessment percentages: 25 percent for car parks; 30 percent for race tracks, telephone and pipeline companies, and most small retail businesses; 50 percent for lawyers, doctors, dentists, engineers, and other professionals, agents, radio stations, newspapers and magazines, photographers, printers, stock or commodity exchange operators, department stores or retail chains with more than five outlets in the province; 60 percent for manufacturers, mines, smelters, and concentrators; and 75 percent for wholesalers, financial institutions, courier and delivery companies, brewers, and distillers (Ontario Fair Tax Commission 1993, 724-5).

[10] Subsequent to a comprehensive review of the public finances of the three levels of government in the aftermath of the Great Depression, the Rowell-Sirois Commission recommended that “the provinces and *ipso facto* their municipalities should withdraw entirely from the personal income tax field”, citing the need for a centralized contol over rates, exemptions and the “appropriate curve of progressivity”. (Report of the Royal Commission on Dominion-Provincial Relations 1940, 111-112)

[11] As the Rowell-Sirois Report comments: ‘the outstanding feature of the Ontario revenue system is the high yield, both proportionately and absolutely, of real property taxation. This particular source has long been the backbone of Ontario public finance as might be expected from the highly urbanized character of the economy.” (Report of the Royal Commission on Dominion-Provincial Relations 1940 Vol. 1, 230). Cryptically, the Commission also noted that “anything which had an adverse effect on real estate values would undermine Canadian municipal finances.” (Report of the Royal Commission on Dominion-Provincial Relations 1940, Vol. 1, 130).

[12] The pattern of real per capita municipal expenditure mimics the pattern of growth and decline in real per capita assessments in the years for which data is available. Total expenditure increased from $10 per capita in 1900 to $15 by 1910. By 1924, total expenditures had reached nearly $20 per capita (in 1900 dollars). The peak was reached at nearly $30 in 1932 and fell to close to $14 by 1941- reflecting deflation and reduced pressure on municipalities to spend on relief and debt charges. School expenditures per capita increased from $3.32 per capita in 1910 to just over $8 in real terms by 1933 and then declined to just over $4 by 1941.

[13] Much of this section is based on Slack (2000).

[14] The Smith Committee also recommended that a 'basic shelter exemption' should be introduced to help low-income residential taxpayers. The provincial government pre-empted this recommendation by introducing a version of such an exemption in 1967. In 1972, this was replaced by a property tax credit under the provincial income tax, as analyzed in Bird and Slack (1978). Since the federal government actually administers this tax, the fascinating outcome was that a federally-administered provincial tax credit was used to offset the presumably regressive incidence of a municipal tax: Canadian intergovernmental politics at its best! While this credit still exists, it has long been forgotten by all combatants in the property tax wars, since it seems universally to be viewed as a component of the income tax rather than the property tax system, a conclusion with which we concur. We shall not consider this aspect of the property tax in detail in the present study.

[15] Where the business property was unoccupied, it was not subject to the business tax and the residential tax rate was applied.

[16] Multiple residential units were taxed at the residential tax rate. They were, however, over-assessed compared to single-family homes and more so in Metro Toronto than in other parts of the province (see Bird and Slack 1978: 13 and Ontario Committee on Taxation 1967, 248-9).

[17] Metro Toronto was a two-tier government from 1954 to 1998. From 1967 to 1998, there was an upper-tier metropolitan government and six lower-tier municipalities. In 1998, the upper tier and the lower tiers were amalgamated into what is now known as the City of Toronto.

[18] More recent information (for 1991) showed that the assessed to market value ratio was 6 percent for multi-residential units compared to 1 percent for single-family units in Toronto. In neighboring Mississauga, the assessed to market value ratio was 22 percent for multi-residential units compared to 13 percent for single-family units (Ontario Fair Tax Commission 1993, 614).

[19] For a critical discussion on this approach, and a comparison with market value assessment, see Slack (2006).

[20] The over-taxation of non-residential properties is documented in Kitchen and Slack (1993).

[21] The term "current value" assessment should not be confused with the term "value in current use." Current value is the same as market value and refers to the highest and best use. It was likely chosen because it sounded different than market value which had received such a negative response for so many years.

[22] Two additional optional classes - professional sports facilities and resort condominiums -- were added in 2000 and 2005 respectively.

[23] In 2002 municipalities were given the option of reducing the property tax on farmland to less than 25 percent of the residential tax rate. The decision to lower the rate has to be made annually.

[24] These differentials reflect differences that existed across the province prior to the provincial takeover of education funding in 1998. The province was not keen to move to a uniform rate on business education taxes because of the winners and losers that would result.

[25] For reasons discussed at length in Bird and Slack (1978) and more recently elegantly set out in Zodrow (2001) and Fischel (2001), we do not accept this view of property tax incidence. In the present context, however, what is more important, we suggest, is that this appears to be the view that largely frames public policy in this area.

[26] See the exchange between Moore (2002) and Harris and Lehman (2002).

[27] The ratio on multi-residential properties could be this high because of the over-assessment of these properties compared to single-family homes (see footnote 18).

[28] The introduction of the large industrial class reduced tax shifting to small industrial properties in one-industry towns.

[29] The limits on tax increases were additive, not compounded. In other words, taxes on a property in 1998 could not exceed 110 percent of the taxes levied in 1997. For 1999, the taxes on a property could not exceed 115 percent of its 1997 taxes, and for 2000 the taxes could not exceed 120 percent of the property's 1997 taxes. However, taxes could exceed the limits if there was a physical change to the property or if the municipality increased tax rates.

[30] In the months following the announcement of the investigation, the Ombudsman's office received 3,720 additional complaints (Ombudsman 2006, 3-4).

[31] In 2006, 116,089 properties made requests for reconsideration for a total reduction in assessment of $3.18 billion; 44,226 properties filed complaints with the Assessment Review Board for a total reduction in assessment of $3.56 billion. In total, 3.57 percent of properties made a request or filed an appeal for a reduction in assessment of 0.50 percent (MPAC 2006 Annual Report, 12).

[32] Much of the following is based on Slack (2005) and Bird and Slack (2004).

[33] In some cases, however, mortgage institutions include property tax payments with monthly mortgage payments. This procedure reduces the visibility of the property tax for taxpayers who pay their taxes along with their mortgage payments.

[34] Recall that one criticism by the Ombudsman (2006) of the MPAC approach was that even if there was a sale on the date of the valuation, the sale value was not necessarily acceptable for property tax purposes: this is indeed a strange market (or current) value system. MPAC's

response to date (MPAC 2006, 9) is that "greater weight is [now] being given to the actual selling price of homes when an assessment is challenged." Is this an adequate answer?

[35] Some years ago, for example, Buchanan and Forte (1964) noted that one argument for excise taxes as opposed to general sales taxes was that consumers felt they had more choice when it came to the former, and choice has a positive value.

[36] Of course, this analysis is based on a number of assumptions such as local governments do what voters want them to do and voters are free to move to other jurisdictions if they do not like the combination of services and tax rates. For a more detailed discussion of assumptions, see Bird and Slack (2004, 10). In contrast to the benefit view of taxation, others see the property tax as a tax on capital. See Fischel (2001) for a discussion of the benefits view and Zodrow (2001) for the tax on capital approach.