Municipal Tax Ratio Policy

Recommendation
That the Standing Policy Committee on Finance recommend to City Council that the policy of utilizing a ratio of non-residential to residential tax rates continue to be used as the City of Saskatoon's tax policy for 2017.

Topic and Purpose

The purpose of this report is to inform City Council of the impact of the 2017 property reassessment on the current local tax policy, and to request City Council approval for the continued policy approach of a non-residential to residential tax ratio.

In addition, the report provides research, analysis and municipal comparisons for City Council to determine a specific tax ratio to apply in 2017.

Report Highlights

1. The 2017 reassessment saw commercial assessment values increase at a higher rate than residential assessment values (36% vs. 14% on average).
2. The 2017 Revenue Neutral Tax Ratio is 1.47.
3. Saskatoon is the only municipality in Western Canada with a targeted tax ratio.
4. The ability for business property owners or non-residential property owners to deduct property taxes from their corporate income tax requirements formed the basis for Saskatoon's tax ratio of 1.75.
5. Both residential and non-residential taxes are second lowest of major Western Canadian Cities.

Strategic Goal

One of the long-term strategies for the Strategic Goal of Economic Diversity and Prosperity is ensuring Saskatoon has a competitive tax regime with solid, clear and reasonable public policies. The discussion pertaining to the ratio between residential and commercial property taxes relates to competitive rates for both residential and commercial property taxes.

Background

In 2001, the City of Saskatoon (City) implemented a 10-year plan that reduced the ratio of commercial to residential tax rates from 2.41 to 1.75. The reduction to the tax ratio was the result of the June 15, 1998 City Council decision, which was based on a recommendation put forth by the Local Tax Review Committee (1997).

The recommendation from the Committee focused on tax equity and fairness in that residential and non-residential properties should pay an equal amount of property taxes if the properties have the same assessed value. The recommended effective tax ratio of 1.75 utilized this equity and fairness concept, which was adjusted for the benefit businesses receive from the deductibility of property taxes in the determination of income for income tax purposes. The shift to the 1.75 ratio was completed in 2010 and has since been maintained on the City's and Library's share of the property taxes (Education tax rates are set by the Province and are therefore not included in the tax ratio calculations).

In 2012, the Greater Saskatoon Chamber of Commerce proposed a further reduction in the ratio to 1.43, based on the fact that the income tax rates were less than they were when the original 1.75 ratio was approved. The Administration supported this recommendation in a report to City Council on October 21, 2013, as it was based on the original concept of fairness and equity between the residential and non-residential tax classes. At that meeting, City Council resolved that the tax ratio of 1.75 remain in effect and that the matter be considered with the next revaluation cycle in 2017.

At its meeting on November 21, 2016, the Governance and Priorities Committee received an information report from the CFO/General Manager, Asset and Financial Management Department, on Financing Growth – Hemson Study Update. This update report referenced the recommendation from the original Hemson Study, tabled with the former Executive Committee in April 2015, that the City investigate ways of increasing non-residential taxable assessment.

Report

Tax Policy Ratio

Every year, City Council approves tax policy recommendations from the Administration. Since 2001, the recommendations have included the movement towards, and later the maintaining of, the non-residential effective tax rate at 1.75 times higher than the residential effective tax rate. Recently, there has been a lot of focus on this ratio and whether or not it should be adjusted.

The Administration has prepared a discussion paper (Attachment 1) to provide a comprehensive overview of business property taxation issues and the impact on residential property taxes. The discussion paper integrates theoretical frameworks in the economic literature with practical analysis of how selected cities approach the issue of business property taxation.

Revenue Neutral

At the beginning of every reassessment cycle, the Administration calculates the revenue neutral tax rate for each property class (i.e. when assessments increase, there is a corresponding decrease in tax rates so that the same taxation dollars are collected for each property tax class). Once revenue neutral is determined, budgetary adjustments and tax policy decisions are applied to the new (reduced) tax rates.

Impact of the 2013 and 2017 Reassessments

The 2013 reassessment saw the average non-residential assessment increase more than the average residential assessment increase (92% vs. 83%). This meant that the revenue neutral ratio between non-residential and residential properties was approximately 1.66. At its April 8, 2013 meeting, City Council resolved that the tax ratio should remain at 1.75. This resulted in a decrease of about 1.5% for residential taxes and an increase of approximately 3.7% for the non-residential tax class.

In 2017, the reassessed value for the average non-residential assessment again increased more than average residential assessment increase (36% vs. 14%). The result of this variance is the 2017 revenue neutral tax ratio between non-residential and residential property classes has decreased to approximately 1.47. This means that in order to collect the same amount of taxes from each property class in 2017 as in 2016, City Council would need to approve a 1.47 ratio. Any other ratio would result in the shifting of taxes between residential and non-residential properties.

Hemson Report and Local Business

One of the recommendations in the Financing Growth Study (also referred to as the Hemson Report) was that Saskatoon should investigate ways to increase the non-residential assessment which would, over time, reduce the overall tax burden on residential properties. This aligns with the proposal in the 2012 paper from the Greater Saskatoon Chamber of Commerce which stated that a lower non-residential tax rate would increase taxable assessment in that property class.

During the past two reassessment cycles (2013 and 2017) in Saskatoon, non-residential property values increased at a higher rate than residential property values. This assessment value differential caused a reduction in the revenue neutral tax ratio (i.e. the revenue neutral tax ratio goes down if commercial properties increase on average more than residential properties). However, although there appears to be a correlation between a lower tax ratio and increased business taxable assessment, there is no way to determine if this was the result of the 1.75 tax ratio, economic influences, or other market forces (Section 7 of discussion paper).

Business Property Taxes and Competitiveness

The general consensus within the available economic literature is that high business property taxes can affect competitiveness, but the literature does not define what "high" is. To provide a current context, a December 2016 report by the C.D. Howe Institute concluded that Saskatoon had the most competitive business tax environment for capital investment when compared with the largest city in each province. This suggests that Saskatoon's current business property taxes would not be considered "high" as compared to other jurisdictions. Section 4 of the discussion paper addresses the issues pertaining to business property taxes and its impact on competitiveness.

Tax Equity and Fairness

The concept of "equity" is a fundamental principle of taxation. For taxation purposes, it implies that the burden of a tax should be shared fairly among individuals so that there is an equitable distribution of the cost of government to society (Section 2 of discussion paper).

Saskatoon's Local Tax Review Committee (1997) was concerned by the tax rate differential (Section 1.1 of discussion paper) and believed that there was no basis for charging businesses higher tax rates when in fact the residential properties received more services for the taxes than paid (Section 4.2 of discussion paper). The equity issue, combined with the ability for business property owners or non-residential property owners to deduct property taxes from their corporate income tax requirements, formed the basis for the adoption of a targeted non-residential to residential tax ratio of 1.75.

Equity and fairness, however, can be subjective depending who is the beneficiary of specific tax policy. For example, residential property owners may view the Calgary and Edmonton model (Section 5 of discussion paper) as more equitable in that both property classes share equally in property taxes increases.

Comparisons with Other Municipalities

As detailed in Section 5 of the discussion paper, the Administration's research indicates that no other major Western Canadian city has a targeted tax ratio policy. Some municipalities, such as Regina, use a revenue neutral approach while others like Calgary and Edmonton use a budget based, or tax share approach. However, Table 3 on page 20 of the attached discussion paper shows that of the major Western Canadian Cities, Saskatoon's property taxes are second lowest for both residential and non-residential property classes. Whether or not this favourable tax ranking is due to Saskatoon's current tax ratio policy could not be determined due to differences in provincial funding agreements, economic factors and general differences in municipalities' revenue streams.

Conclusion

The economic literature is inconclusive in terms of the impact that a tax ratio policy has on business decisions and whether there is an optimum tax ratio. While the literature cites that high business property taxes will discourage business development, there is no consensus on what high means.

Saskatoon has seen increases in commercial assessment values, but according to the literature, this may or may not be related to having one of the lowest effective tax rates in Western Canada. In addition, there is no standard practice amongst municipalities when it comes to differential taxation for business properties, as it appears that tax policies depend on community values.

Based on the City's long-term strategy of having a competitive tax regime with solid, clear and reasonable public policies, the Administration is making a recommendation based on the direction from previous City Councils that Saskatoon should have a targeted tax ratio policy in 2017 based on equity and fairness. Within this recommendation, City Council will also need to determine the specific ratio on which to target in 2017 based on the presented research and analysis.

The past practice of City Council focused on a targeted ratio which aimed at residential and non-residential having the same property tax burden adjusted for the benefit businesses receive from the deductibility of property taxes in the determination of income for income tax purposes. To continue this principal, the ratio in 2017 would be 1.37 resulting in a shift of 2.1% of taxes to residential and a 5.0% decrease for non-residential properties. The following table summarizes all of the options City Council has in determining a specific ratio and corresponding taxation effect of any resulting shift:

Options 1, 2 & 3	% Impact Residential			% Impact Non-Residential			%Tax Mix Result	
	Shift	Tax*	Total	Shift	Tax*	Total	Res	Non-Res
(1) Targeted Tax Ratio								
a) Maintain Ratio @ 1.75	-5.2	4.2	-1.0	12.6	4.2	16.8	67.2	32.8
b) Reduce Ratio to 1.43	0.9	4.2	5.1	-2.0	4.2	2.2	71.5	28.5
c) Reduce Ratio to 1.37	2.1	4.2	6.4	-5.0	4.2	-0.8	72.3	27.7
d) Increase Ratio to 2.0	-9.5	4.2	-5.3	23.0	4.2	27.2	64.2	35.8
(2) Revenue Neutral								
Ratio is 1.47	0.0	4.2	4.2	0.0	4.2	4.2	70.8	29.2
(3) Tax Share (budget)								
a) 50/50 Tax Share	0.0	2.9	2.9	0.0	7.1	7.1	70.2	29.8
b) 60/40 Tax Share	0.0	3.5	3.5	0.0	5.7	5.7	70.6	29.4
c) 65/35 Tax Share	0.0	3.8	3.8	0.0	5.0	5.0	70.8	29.2

It is important to note that Option 3, a tax share approach, illustrates the property tax impact if the 2017 budgetary increase was applied 50/50, 60/40 or 65/35 to residential and non-residential properties. This approach would slowly move the City towards the targeted tax share over a period of several decades and would not immediately result in the desired tax share.

Options to the Recommendation

City Council has the following two options aside from the recommended tax ratio approach:

<u>Option 1</u>: The revenue neutral approach (Option 2 in the table above) which allows for growth and market forces to dictate the ratio.

<u>Option 2</u>: The tax share approach (Option 3 in the table above) which focuses on the split of overall taxes that is paid by residential and non-residential.

Public and/or Stakeholder Involvement

The Administration's research included and considered reports and analysis from the Greater Saskatoon Chamber of Commerce.

Communication Plan

A comprehensive communications plan will be developed to create awareness and understanding of the various options that will be considered for the 2017 Municipal Tax Ratio Policy. Communication tools will include, but may not be limited to, the following:

- A news release will be issued to highlight the tax policy options within this report, and subsequent news release(s) will be issued once City Council adopts the tax ratio policy for 2017.

- To ensure transparency, administrative reports and related documents, such as *Discussion Paper on Business Property Taxation By Cities* and *Frequently Asked Questions,* regarding the Municipal Tax Ratio Policy will be given an online presence on saskatoon.ca.

- Once City Council has decided on the best tax policy decision for Saskatoon, the website will be further updated to ensure access to information on the matter.

Policy Implications
The current tax ratio is that commercial properties will have an effective tax rate of 1.75 times that of residential properties. City Council's decision may affect the current policy.

Financial Implications
The result of any change to the ratio will be revenue neutral to the City.

Other Considerations/Implications
There are no environmental, privacy or CPTED implications or considerations.

Due Date for Follow-up and/or Project Completion
Tax policy decisions must be approved at the March 27, 2017 meeting of City Council in order to facilitate the compilation of the mill rate bylaws which will be tabled at the April 24, 2017 meeting of City Council.

Public Notice
Public Notice pursuant to Section 3 of Policy No. C01-021, Public Notice Policy, is not required.

Attachment
1. Business Property Taxation by Cities; A Discussion Paper, dated March 6, 2017

Report Approval
Written by:	Joanne Stevens, Manager of Finance Special Projects Mike Jordan, Director of Government Relations
Reviewed by:	Clae Hack, A/General Manager, Asset & Financial Management Department
Approved by:	Murray Totland, City Manager

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