COUNCIL REPORT

Edmonton

PROPERTY TAX SYSTEM

RECOMMENDATION

That the February 15, 2023, Financial and Corporate Services report FCS01361, be received for information.

Requested Council Action		Information only	
ConnectEdmonton's Guiding Principle		**ConnectEdmonton Strategic Goals**	
CONNECTED This unifies our work as we work to achieve our strategic goals.		**N/A**	
City Plan Values	LIVE. THRIVE.		
City Plan Big City Move(s)	Inclusive and compassionate	**Relationship to Council's Strategic Priorities**	Conditions for Service Success
Corporate Business Plan	Serving Edmontonians		
Council Policy, Program or Project Relationships	N/A		
Related Council Discussions	N/A		

Previous Council/Committee Action

At the June 20, 2022, City Council meeting, the following motion passed:

> That Administration provide a report that discusses how the property tax system might be changed to create a more progressive taxation system.

Executive Summary

- The property tax system measures property owners' wealth and ability to pay based on property values.
- There are limited tools available to make a property tax system more progressive.
- Administration has considered several approaches, but most are inadvisable given legislative limitations and the role of the municipal governments.

REPORT

The International Association of Assessing Officers defines a "Progressive Tax System" as:

> A method of taxation in which those with more resources pay a greater percentage of their resources than those with fewer resources.

Property tax is a unique form of taxation as compared to income taxes or sales taxes (consumption/excise taxes). Property tax, also known as an ad valorem (according to value) tax, is based on property wealth, and determines ability to pay based on property value. This is distinct from income tax, which is directly linked to income and determines tax distribution based on this same metric.

The fundamental metric for determining equity in a property tax system is assessed market value, and it is both difficult and ill-suited to use income as a metric for tax fairness under a property tax system. When arguments are made linking property to income tax, outlier cases are typically used to argue that property tax is regressive (a common example is a senior on fixed income who owns a property that has appreciated in value). Property tax is, in fact, proportional to what it taxes, which is property wealth.

Every method of taxation has strengths and drawbacks. A non-residential property owner, for example, may pay little to no income tax in a given year based on reported losses, but would still pay property tax. This is why a suite of taxation tools is preferable over reliance on a single tool and while Alberta municipalities are primarily limited to property tax, property tax makes up a proportionately small amount of the overall tax property owners pay. Based on 2019 data from Statistics Canada, property tax in Edmonton typically represents about two per cent of household expenditures. Property taxes average about seven per cent of the total taxes paid within a typical two-income household (with income tax constituting 62 per cent).

The following points add context to consideration of a progressive property tax system:

- The fundamental metric in a property tax system is property value and fair distribution of taxes will always start with this as its foundation.
- Property wealth and income are different measures of an individual's ability to pay. Income tax already adjusts tax distribution based on income, whereas property tax is distributed based on property wealth.
- While there are exceptions, there is also often a strong link between property wealth and ability to pay. Property purchases, for example, take into account an individual property owner's ability to qualify for and pay the mortgage.

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- Real estate is one area where higher net worth individuals invest and keep savings. Property tax ensures those individuals are contributing towards the general tax base.
- Property assessment changes do not automatically result in tax increases for property owners. Assessment values only determine the distribution of the tax levy as approved by Council. Property owners that experience typical market trends will also experience typical tax changes.
- While property tax is criticized as continually taxing a fixed asset, property tax supports the provision of municipal services and maintenance of local infrastructure upon which Edmontonians depend. This is in some ways analogous to costs incurred by homeowners for regular property upkeep.
- Property owners on fixed incomes have tools available to them to leverage their property wealth to offset the associated property tax costs (e.g., deferral programs).

The remainder of this report outlines how subclassing can be used to introduce elements of progressivity into a property tax system, but the emphasis remains on progressivity associated with property wealth rather than income. Generally, the current legislative framework tends to support a proportional tax system.

Residential Tax Subclasses

There are limited tools available to make a property tax system more progressive. As there is no legislative flexibility in the assessment of properties, setting different tax rates for property classes and subclasses is the primary tool available for the City to address property tax incidences. For example, the City currently taxes non-residential properties at approximately three times the rate it taxes most residential properties. Council may also divide the residential class into subclasses on any basis it considers appropriate to set different property tax rates for different types of residential property. The City currently has one residential subclass called Other Residential, comprising properties with four or more dwelling units on a single title, which is currently taxed at a 15 per cent higher tax rate than most residential properties such as single detached houses. While the authority to create residential subclasses is broad, there are legal constraints to consider and potentially significant legal risk if an improper subclass is established.

Administration has considered several approaches to using subclassing to create a more progressive property tax system, though most are inadvisable due to legal risk or practical constraints. There are few precedents and little case law associated with certain types of progressive subclasses, and any subclasses under consideration should be carefully evaluated from a legal risk perspective. Practical risks include the potential for a large number of assessment complaints which could increase tax losses and administrative costs.

To reduce these risks, it is best to ensure that residential subclasses are based on the verifiable physical characteristics of a property, such as its type (e.g.,detached houses, apartments), its size (e.g., square footage of a lot or a house), or its characteristics (e.g., presence of a particular attribute, year of construction). Subclasses that are based directly on the characteristics of its occupants, such as household income, are likely not authorized under provincial legislation. Because the legislation does not contemplate linking property tax with income, the property tax system is inherently limited in its ability to address progressivity from an income perspective. Municipalities also do not have a reliable method to access accurate income information at an individual taxpayer level.

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Some subclassing approaches would have higher risk than others. For example, properties are assigned a quality rating as part of the assessment process, and a subclass could be established to set a higher tax rate for properties that receive a higher quality rating. However, these ratings are subjective and there is a significant risk that this type of subclass would lead to many complaints that would be difficult to defend.

Another approach would be to set different tax rates for different portions of a single assessment. For example, one tax rate would apply to the first $1 million of the assessment, and a higher tax rate would apply to any assessment above that threshold. This approach is used for education taxes in British Columbia, where an additional tax rate applies to most high-valued residential properties in the province. The additional tax rate only applies on the portion valued over $3 million, and does not apply to non-stratified rental buildings with four or more housing units (such as apartment buildings). The additional tax rate is 0.2 per cent on the residential portion assessed between $3 million and $4 million, and 0.4 per cent on the residential portion assessed over $4 million. This approach would come with significant risks for a municipality in Alberta as the *Municipal Government Act* does not contemplate these types of subclasses.

Value-Based Subclass Approach

Another subclassing approach to address progressivity would be where the tax rate is entirely determined by the value of the property. Under this approach, subclasses would be defined using value thresholds and a single tax rate would apply depending on the total value of the residential portion of the property. For example, residences with properties valued at less than $1 million would pay one tax rate, and residences valued above that threshold would pay a higher rate (though, the thresholds would need to be clearly defined and justified). While theoretically possible, this approach also comes with similar legal and practical risks and constraints as mentioned above and discussed in more detail in Attachment 3 of the February 15, 2023, Financial and Corporate Services report FCS01153, Residential Subclasses and Options for 'Other Residential' Phase-Out.

For this analysis, properties currently classed as “other residential” have been excluded since this subclass is the subject of report FCS01153. The remaining properties considered “residential” for this analysis include separately titled condominiums and any parts of mixed-use properties used for permanent living accommodations. As well, a number of properties captured in these totals may also include plots of bare land and properties that have a number of homes on one title.

In Edmonton as of 2022, there were just over 4,800 residential properties valued at or over $1 million, accounting for nearly $8 billion in property assessment and $53 million in municipal property taxes. Assuming a revenue neutral approach, a 10 per cent higher tax rate on properties valued at or over $1 million would result in a 0.3 per cent reduction for properties valued below $1 million. The impact would be much smaller if the threshold were set at higher levels - for example, there were about 700 properties valued at more than $2 million and only about 250 properties valued at more than $3 million.

	Number of Properties	Total Assessment	Total Municipal Tax Shift*	Tax Reduction for Properties Below Threshold*
Assessed >$1 Million	4,800	$8 Billion	$5.3 Million	0.3 Per cent
Assessed >$2 Million	700	$2.5 Billion	$1.65 Million	0.09 Per cent
Assessed >$3 Million	250	$1.5 Billion	$1.0 Million	0.06 Per cent

* = Based on a 10 percent higher tax rate for higher-valued properties

While possible, this approach comes with considerable drawbacks. It is likely to lead to increased assessment complaints for properties above the threshold. Under the current system and using 2022 tax rates, every dollar of assessment is worth about 0.7 cents of tax. If properties worth more than $1 million had a 10 per cent higher tax rate, the small dollar difference between a $999,500 property and a $1 million property would be worth about $689 of tax. This makes it more worthwhile for a property owner to file a complaint if their property is above the threshold. Horizontal equity may also be questioned as two property owners separated in home value by $500 may see significantly different tax incidence.

All properties are re-assessed every year, and values can shift considerably based on market values even if there are no physical changes to the property. This means that properties could shift from one subclass to another as the market changes from year to year, reducing predictability and certainty for both property owners near this threshold and the remaining tax base. This approach adds volatility to the remaining tax base because, as markets increase or decline, the number of homeowners paying at the higher rate would change, adjusting the distribution of taxes across the subclasses, including the general residential class. Since property values generally increase over time, a subclass defined by a static value threshold is likely to grow over time and may need to be adjusted to achieve a similar result; however, Administration recommends against regular changes to the City's subclassing structure to maintain certainty and predictability for taxpayers. Greater tax predictability helps taxpayers budget for tax increases over time, which improves tax tolerance.

Since property value is not directly linked to income, a higher tax rate on higher-valued properties would also exacerbate situations where a highly valued property is owned by a person with relatively lower income (such as the example of a senior on a fixed income noted earlier). Such circumstances may be more prevalent in central areas of the City where land values have increased and form a larger share of the overall assessment.

Provincial Advocacy

The above analysis is based on introducing elements of progressivity into a wealth-based tax system. There are a number of legal risks and practical constraints with any of the approaches outlined. These risks could be mitigated through provincial legislative change, but would require successful advocacy to the Government of Alberta.

Legal Implications

The creation of new residential class subclasses is possible but must be done in accordance with the requirements of the *Municipal Government Act* and associated caselaw. Attachment 3 in report FCS01153 outlines the legal requirements for the creation of a new residential subclass.

COMMUNITY INSIGHT

Administration conducted a limited engagement in summer and fall of 2022 about how the property tax system could be changed to support The City Plan; this engagement addressed a number of issues including property tax subclassing. The engagement asked about subclassing in general terms to gauge support for using tax policies to ensure that taxes are distributed fairly and achieve policy objectives. 51 per cent of participants agreed that it is very or somewhat appropriate to use tax subclassing to change tax distribution. As such, a subclassing structure intended to address perceived issues of fairness may receive some public support, though perceptions of fairness differ. However, additional engagement would need to be conducted to determine if Edmontonians support the concept of progressive taxation specifically.

GBA+

The GBA+ considerations of this report, as with nearly all property tax policy matters, relate to the individuals who own property. As a practice, property taxation is not related to any individual's gender, race, ethnicity, religion, age or disability, in that the amount of taxes is based solely on a property's value. A feature of the property taxation system is that, in most cases, a property's value can be used as a proxy for determining a property owner's ability to pay the tax.

While no current Alberta-specific information is available, Statistics Canada has analyzed the income characteristics of residential property owners in British Columbia, Ontario and Nova Scotia exploring the relationship between owner income and property values. Based on findings, the income of residential property owners is considerably higher than the income of those who do not own any residential property. In each of the three provinces, residential property owners also tend to be significantly older than those who did not own property, with the median age of owners around 55 years old while that of individuals who did not own property around 37 years old.

Older analysis from Canada Mortgage and Housing Corporation suggests these trends also apply in Edmonton. In 2011, Edmonton homeownership rates generally increased with the age of the primary household maintainer (i.e., the person who pays the mortgage, taxes and utilities). The ownership rate was highest among the 65-74 age category (83 per cent), before dipping to 81 per cent among those 75 and older. Also in 2011, the real median after-tax income of owner households in Edmonton was $76,000, but just $42,600 for renter households.

While these statistics shift over time, these findings suggest that making Edmonton's property tax system more progressive may impact older residents more directly as they would be more likely to own property. However, the exact impact is difficult to determine since the amount of wealth in property held by older people is unknown. A significant amount of public consultation would need to be undertaken by Administration to better understand the possible impacts of such a change on Edmontonians across GBA+ characteristics.