

## IS 'CHARTER-CITY STATUS' A SOLUTION FOR FINANCING CITY SERVICES IN CANADA — OR IS THAT A MYTH?

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### SUMMARY

In 2007, the province of Ontario effectively granted Toronto “charter-city status,” handing the municipal government a new arsenal of tools it could use to raise additional revenue. Charter-city status has often been held up as a reasonable way to help satisfy municipal-financing demands without cities relying on property taxes and provincial transfers — something municipal politicians have been known to say they very much need. Since Toronto got its charter, however, the city has barely touched these tools. Free to impose municipal levies on bars, cars, land sales, parking lots, billboards and road tolls, the city has so far only implemented a tax on billboards and land transfers. It tried taxing vehicle registrations, but that tax was soon cancelled.

Toronto is not unique in that it has been given special legislation to levy municipal taxes beyond traditional property taxes: There are nearly a dozen cities across Canada that now benefit from similar legislation. They have proven even less inclined to use additional revenue tools. Calgary and Edmonton signed a memorandum of understanding with the Alberta government to gain charter-city status; the process has gone no further than that.

Most often, the reason Canada’s so-called charter cities do not seize the apparent opportunity provided by this special legislation is that it typically does not provide them that many additional tools. Toronto is, in fact, exceptional in the range of taxes it can use. One possible reason that Canadian charters have been kept within rather confining bounds is that provinces tend to be reluctant to share their tax bases more than they already do through property tax sharing.

But if Toronto is any guide, even having a wider scope of taxing powers does not mean a city will take advantage of them. It may be that local politicians relish the idea of new taxes in theory, but recoil at the political reaction the new taxes are sure to provoke. After all, former Toronto mayor Rob Ford’s 2010 election was partly based on voters’ annoyance over the city’s personal-vehicle-registration and land-transfer taxes, and his vow to change them. That the city then eliminated the vehicle tax, but not the land-transfer tax, may have to do with the latter being borne considerably by future residents of the city, who are not yet voters.

Given cities’ growing funding responsibilities, it behooves them to find revenue-raising tools they are willing to use. Notwithstanding Toronto’s experience, vehicles are inefficiently priced, occupying roads and parking with little incentive for drivers to ration their usage. Fuel taxes and taxes on vehicle registration can be easily tacked onto provincial taxes and transferred back to cities, and so can be efficient, fair, accountable and transparent. The technology for toll roads, meanwhile, is readily available, even if the political will is not, and an advantage of tolls is that they collect revenue from commuters who use the city’s services, but live outside its boundaries. Similarly a municipal income tax, ideally charged on local businesses’ payrolls, would raise revenue from everyone working in the city, even if they lived elsewhere.

Of course, as Toronto’s experience demonstrates, new taxes can be difficult to sell politically. The best remedy for this is to earmark taxes for specific spending priorities. This has the added benefit of facilitating long-term planning and preventing the abuse of funds. And raising funds locally, rather than relying on transfers, increases municipal accountability and efficiency, encouraging better fiscal discipline. The charter-city experiment has so far been discouraging, but it would certainly stand a better chance were provinces willing to grant more access to their tax base, and were municipal politicians more willing to defend their need to use it.

A charter city is created by a legal document that, in theory, differentiates that city from other municipalities in the same provincial jurisdiction. In Canada, charters are granted by provincial governments. In theory, their role is to provide cities with flexibility in terms of reform, spending responsibilities and access to revenue. In practice, the story often differs. Cities with charter status almost always have the same spending and service responsibilities as other municipalities. In a few cases, charter cities are permitted to use more revenue tools than those that are available to non-charter cities, but the additional revenue sources tend to be minimal in both their scope and their revenue-raising capacity.

Discussions around the advantages of charter-city status may differ, but for the purpose of municipal financing, which is the subject of this paper, proponents are generally united in their view that it means access to more revenues in the form of grants and new taxes.

This paper is organized in the following way. Part A summarizes the city-charter or special-legislation status of three large cities in Canada as it applies to regulatory powers, spending responsibilities, and revenue-raising tools. Part B looks at charter status and current taxation powers. Part C asks whether it has been proven to be a myth that charter city status is better for financing city services. Part D looks at the charter status and asks whether it can be a solution. Part E summarizes the paper.

## **A. CITY CHARTERS AND SPECIAL LEGISLATION**

There are five charter cities in Canada: Saint John (the oldest), Montreal, Winnipeg, Vancouver, and Lloydminster (a city that straddles both Alberta and Saskatchewan). In addition, some cities have special legislation that is similar to a charter but is not explicitly called a charter. These cities are Toronto, St. John's, Corner Brook, Nfld. Mount Pearl, Nfld. and Charlottetown (the Charlottetown Area Municipalities Act also governs the towns of Stratford and Cornwall in P.E.I.). Edmonton and Calgary have both signed a memorandum of understanding (MOU) with the province to pursue charter status, but the process has not been completed. In fact, it has barely been initiated.

Since each charter in Canada was written to recognize the particular needs of each city and since each was written in a different time period, it is not surprising that they are all different. In some cases, such as Vancouver's, the charter was written years ago and well before the more recent municipal legislation that applies to the rest of the province. In other cases, such as Toronto's, both the city's legislation and the general municipal legislation are relatively new. Newer legislation tends to incorporate modern concepts such as "natural-person powers,"<sup>1</sup> "spheres of jurisdiction," the formal recognition of municipalities as an order of government, and intergovernmental consultation. In other cases, such as Montreal's, the charter gives the city some additional powers but these are not significant.

The following compares city charters and special legislation with the general municipal government act for three Canadian cities. This discussion is not meant to be comprehensive; that would require a detailed legal interpretation of each section of the various pieces of

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<sup>1</sup> Natural-person powers are intended to give a municipality the clear power to do day-to-day things on its own volition without the formerly restrictive provincial constraints that would limit a municipality's power.

legislation. Rather, the discussion below is meant to illustrate the extent to which cities with charter status or special legislation have different service responsibilities, regulatory powers, and revenue sources when compared with other cities in the province in which they are located.

## Vancouver

Vancouver is almost exclusively governed by its charter. The Vancouver Charter<sup>2</sup> is much older (1953) than the Community Charter (2003) and the Local Government Act (1996). Not surprisingly, the newer legislation is more modern and flexible than the Vancouver Charter. In terms of services, the Vancouver Charter itemizes each of the service powers. The Community Charter, on the other hand, sets out the fundamental service power in one sentence: “A municipality may provide any service that the council considers necessary or desirable, and may do this directly or through another public authority or another person or organization” (section 8(2)). In terms of general powers, the Vancouver Charter itemizes corporate powers, whereas the Community Charter substitutes natural-person powers for itemized corporate powers.

With respect to regulatory powers, these are itemized in the Vancouver Charter; the Community Charter defines fundamental regulatory powers as spheres of jurisdiction. Nevertheless, Vancouver has more discretionary development controls than do other municipalities in the province, with more delegation to officials compared to that provided by the Local Government Act. Vancouver maintains its own building code and provides building inspection services; it is immune from legal liability in relation to the operation of its building regulation and inspection function. All other municipalities are subject to the provincial building code and provide building inspection services.

Vancouver’s per capita spending is slightly less (\$1,900 in 2013) than the average<sup>3</sup> for the rest of the province (\$2,050), but the range of services provided by the city is similar to that provided by other municipalities in the province (see Table 1). Broadly speaking, Vancouver has access to the same revenue tools as other municipalities, although the relative importance of each of these sometimes varies; for example, user fees are relatively more important as a revenue generator in Vancouver and property taxes are relatively more important outside Vancouver. As well, provincial grants are smaller in both absolute and relative importance in Vancouver when compared with the rest of the municipalities.

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<sup>2</sup> This legislation superseded the Vancouver Incorporation Act of 1895.

<sup>3</sup> Regional-district expenditures and revenues are not included in this comparison.

**TABLE 1 CITY OF VANCOUVER COMPARED WITH REMAINING MUNICIPALITIES IN BRITISH COLUMBIA, 20131**

Expenditure responsibilities				
Spending by function*	Vancouver		Rest of B.C.	
	per capita \$	% of total	per capita \$	% of total
General government	239	12.6	181	8.8
Protection	518	27.3	400	19.5
Transportation	157	8.3	171	8.3
Water and sewers	225	11.8	218	10.6
Solid waste	30	1.6	50	2.4
Health, social services and housing	57	3.0	5	0.3
Parks, recreation and culture	383	20.1	269	13.1
Development services	30	1.6	50	2.4
Amortization	262	13.8	257	12.5
Other	0	0.0	450	21.9
TOTAL	1,900	100.0	2,050	100.0

\* A more detailed breakdown of the data was not available.

Revenue sources				
Revenue by source*	Vancouver		Rest of B.C.	
	per capita \$	% of total	per capita \$	% of total
Property tax and payments in lieu	983	44.1	986	49.8
User fees	955	42.8	580	29.3
Investment income	32	1.4	47	2.4
Developer contributions	147	6.6	189	9.5
Sale of assets	62	2.8	25	1.3
Other	0	0.0	32	1.6
Total own-source revenue	2,180	97.7	1,859	93.9
Federal transfers	12	0.5	18	0.9
Provincial transfers	38	1.7	104	5.2
TOTAL	2,230	100.0	1,981	100.0

\* A more detailed breakdown of the data was not provided.

<sup>1</sup> Every municipality in B.C. is a member of a regional district. Regional-district expenditures and revenues are excluded from the comparison in this table.

Source: Estimated from British Columbia, Ministry of Community, Sport and Cultural Development, Local Government Statistics, annual.

Breaking down revenue sources in more detail, however, one notes a few more nuanced differences between Vancouver and the rest of the municipalities.

- The payment in lieu of property taxes on linear installations is slightly higher in the Vancouver Charter than in the Community Charter.
- Vancouver can levy development-cost levies for more services (parkland, replacement housing, and day-care centres) than can other municipalities, which can charge only for water, sewers, drainage, and highway facilities.
- Vancouver does not have powers of permissive property tax exemptions but other municipalities do.

The Vancouver Charter does not set out a government-relations framework whereas the Community Charter does require consultations, prohibition against forced amalgamations, a scheme for resolving intergovernmental disputes, etc.

In summary, there are a few financial and regulatory advantages available to Vancouver under its separate charter but it is not necessarily the case that the charter has given it significantly more power than other municipalities in the province. It does, however, recognize that Vancouver is different than other municipalities.

## Winnipeg

Winnipeg is governed almost exclusively by its charter. Unlike Vancouver, the City of Winnipeg Charter (2003), which is a renewal of the City of Winnipeg Act, is newer than the Municipal Act (1997), which applies to other municipalities in the province.

All municipalities in the province have few mandated services and have the authority to act within broad spheres of jurisdiction. The legislation for Winnipeg and the other municipalities is enabling, meaning that municipalities can determine how to deliver programs and services within their jurisdictions. Mandated services are similar in Winnipeg and in the rest of the province. Winnipeg is required to provide: land-use planning, water supply, collection and disposal of household garbage, adoption of building codes and building inspections, and emergency preparedness. Provision of police and fire services in Winnipeg falls under general spheres of jurisdiction and are generally considered to be mandated. Municipalities outside of Winnipeg are required to provide the same services plus municipal roads and maintenance of drains.

The spheres of jurisdiction defined for the City of Winnipeg include: public convenience (i.e., activities and things in private property, off-road vehicles, sale and use of fireworks and firearms, wild and domestic animals); health, safety, and well-being of people and safety, and protection of property; people's activities and things in public places, streets, waterways, flood-control works, drains, and drainage; waste management; police; business and business activities; construction, occupancy, and inspection of buildings; public transportation; water supply; ambulance; and fire protection. For other municipalities in Manitoba, spheres of jurisdiction are similar except they include public utilities but do not include police.

Municipalities outside of Winnipeg are required to get approval for all capital borrowing from the Manitoba Municipal Board. In the case of Winnipeg, the provincial Department of Finance conducts an annual review of the city's financial position and a review of each debt application. The province does not consider in that review the purpose of the debt.

For property-based business taxes, the province sets the maximum tax rate at 15 per cent. Winnipeg has the authority to establish different business classes and set differential business tax rates. Winnipeg can levy frontage levies (on properties fronting on streets or rights-of-way) for the repair and replacement of all streets, sidewalks, and street lighting. The City of Winnipeg is authorized to define business-improvement zones and levy business-improvement taxes on businesses in those zones. Winnipeg can also levy a tax on the consumption of electricity and gas.

Winnipeg has a different governance structure and fiscal arrangement than do other municipalities in Manitoba. When enacted in 2003, the charter provided Winnipeg with enhanced powers and authorities (e.g., tax increment financing, grants, tax credits, etc.). Broad authority for grants and tax credits, and tax increment financing (TIF) were subsequently provided to municipalities outside of Winnipeg (only Brandon has used TIFs).

Table 2 compares per capita spending and revenue along with the relative importance of each for Winnipeg and the average of the other municipalities in the province. Winnipeg's per capita expenditures exceeded the average of the other municipalities by more than \$400

in 2012: \$1,959 versus \$1,548. Spending responsibilities and the relative importance of each service, however, is similar across the province. On the revenue side, per capita revenue was higher in Winnipeg than elsewhere, but access to the various sources and the relative importance of each was similar across the province (Table 2).

**TABLE 2 CITY OF WINNIPEG COMPARED WITH REMAINING MUNICIPALITIES IN MANITOBA, 2012**

Expenditure responsibilities				
Spending by function*	Winnipeg		Rest of Manitoba	
	per capita \$	% of total	per capita \$	% of total
General government	159	8.1	229	14.8
Protection	541	27.6	237	15.3
Transportation	736	37.6	454	29.4
Water and sewers	248	12.7	244	15.7
Environmental health	32	1.6	90	5.8
Public health and welfare	0	0.0	16	1.0
Regional planning and development	81	4.1	27	1.7
Resource conservation and industrial dev.	32	1.6	51	3.3
Recreation and culture TOTAL	130	6.6	200	12.9
	1,959	100.0	1,548	100.0

\* A more detailed breakdown of the data was not provided.

Revenue sources				
Revenue by source*	Winnipeg		Rest of Manitoba	
	per capita \$	% of total	per capita \$	% of total
Property tax and PILs	885	39.2	865	45.5
User fees	285	12.6	208	10.9
Water and sewer	347	15.4	296	15.6
Permits, licences and fines	87	3.8	27	1.4
Investment income	62	2.7	16	0.8
Other	169	7.5	107	5.6
Total own-source revenue	1,834	81.3	1,519	79.9
Provincial grants	334	14.8	288	15.1
Other grants	88	3.9	95	5.0
TOTAL	2,256	100.0	1,902	100.0

\* A more detailed breakdown of the data was not provided.

Source: Estimated from Manitoba, Manitoba Municipal Government, *Statistical Information 2012*.

## Toronto

Both the City of Toronto Act and the new Municipal Act in Ontario came into effect on Jan. 1, 2007. Most of the provisions that apply to Toronto also apply to other municipalities across the province. The most significant difference between the two pieces of legislation is that Toronto has been granted some additional taxing powers. Under the City of Toronto Act, the city has been granted the authority to levy additional taxes, with the exception of taxes on: income, profits, capital, wealth (including inheritance taxes), machinery and equipment used in research or development or manufacturing and processing, payroll, gasoline, natural resources, energy consumption, general sales of goods (except for entertainment, liquor and tobacco), use of highways, and accommodation (including hotels, motels, apartment houses, etc.). The city also cannot levy a poll tax. Another way of looking at this is to say that the city is permitted to tax alcoholic-beverage entertainment establishments, motor vehicle ownership, land transfers, parking lots, road pricing, and billboards. For these taxes, the city can determine the base, rate or amount of tax, methods

of administration, collection and enforcement mechanisms, and any exemptions or rebates. At the moment, the City of Toronto levies a land-transfer tax and a billboard tax; for a short time it levied a \$60 annual personal-vehicle-registration tax (PVT), but this was discontinued in 2011.

For borrowing, Toronto is no longer subject to an annual repayment limit. The city also has additional debt-financing tools: revenue bonds and tax increment financing bonds. The City of Toronto Act mandates an auditor general and an ombudsman, which are discretionary in other municipalities.

Table 3 compares per capita expenditures by function and revenues by source (for 2013) along with the relative importance of each for the City of Toronto and the average of the other municipalities. Per capita spending in Toronto was almost \$950 higher (\$3,684 versus \$2,737). The range of services provided by Toronto is similar to those provided in the rest of the province and the relative importance of each of the spending functions is similar, with a couple of exceptions.

Revenue sources are also similar across the province except for the land-transfer tax, which, as was mentioned above, is used in Toronto (it accounts for more than three per cent of the city's revenue) but is not permitted elsewhere. Also, unconditional grants are not given to Toronto, but they represent about two per cent of all revenue for municipalities in the rest of the province. Conditional grants, on the other hand, are much higher in Toronto than in the rest of the province, but this is largely to fund higher social service expenditures in that city when compared with the rest of the province (\$886 in Toronto versus \$415, which is the average for the rest of the province).

**TABLE 3 CITY OF TORONTO COMPARED WITH REST OF ONTARIO, 2013**

Expenditure responsibilities				
Spending by function	Toronto		Rest of Ontario	
	per capita \$	% of total	per capita \$	% of total
General government	118	3.2	139	5.1
Protection	636	17.3	490	17.9
Transportation	1,033	28.0	589	21.5
Environment	336	9.1	449	16.4
Public health	162	4.4	153	5.6
Social services	886	24.0	415	15.2
Social housing	119	3.2	133	4.9
Recreation and culture	342	9.3	275	10.0
Planning/development	52	1.4	66	2.4
TOTAL	3,684	100.0	2,737	100.0

- General government includes governance, corporate management, and program support.
- Protection includes fire, police, court security, conservation authorities, building permits and protective inspection, emergency measures, and enforcement of the Provincial Offences Act.
- Transportation includes roads and streets, snow and ice removal, parking, public transit, street lighting, and air transportation.
- Environment includes water, sewer, solid-waste collection and disposal, and recycling.
- Health includes public health, hospitals, ambulance, and cemeteries.
- Social and family includes general assistance, assistance to the aged, and child care.
- Social housing includes public housing, non-profit co-operative housing, and rent-supplement programs.
- Recreation and culture includes parks, recreational facilities, libraries, museums, and cultural services.
- Planning and development covers planning, zoning, residential/commercial/industrial development, agriculture and reforestation, and tile-drainage shoreline assistance.

Revenue sources				
Revenue by source	Toronto		Rest of Ontario	
	per capita \$	% of total	per capita \$	% of total
Property tax and PILs	1,387	34.2	1,360	44.3
User fees	847	20.9	604	19.7
Licences, permits and rents	204	5.0	56	1.8
Fines and penalties	59	1.5	39	1.3
Revenue from other municipalities	13	0.3	36	1.2
Land-transfer tax	130	3.2	0	0.0
Other	390	9.6	367	12.0
Total own-source revenue	3,030	74.6	2,462	80.2
Unconditional grants	0	0.0	57	1.9
Conditional grants	1,029	25.4	549	17.9
TOTAL	4,089	100.0	3,068	100.0

- Property taxes: taxes on real property plus payments in lieu of property taxes, and business-occupancy property taxes.
- User fees include water and sewage rates, transit fares, solid-waste and tipping fees, recreation and library fees and other specific charges for using a service.
- "Other" includes development charges, developed land for residential and commercial properties transferred to municipalities, gaming and casino revenues, government enterprise revenues, investment income, and a miscellaneous array of other revenue sources.

Source: Estimated from the Ontario Ministry of Municipal Affairs and Housing, Toronto, *Financial Information Returns*, annual, available at [www.mah.gov.on.ca/fir](http://www.mah.gov.on.ca/fir).

## B. CHARTER STATUS — TAXATION AND BORROWING POWERS

Except for Toronto, Canadian cities with charter status have access to the same set of taxes (mainly property-related) and borrowing powers as do non-charter cities. Toronto's differences arise because it is permitted to use a number of new, mostly minor taxes and has additional borrowing tools. In particular, the city has, in the recent past, used a motor-vehicle-registration levy and currently uses a land-transfer tax that generates about nine per cent of revenue from property taxes and payments in lieu of property taxes. These taxes are not without controversy when it comes to financing municipal operating budgets. On the capital side, Toronto has been granted two new borrowing tools: revenue bonds and tax



incremental financing bonds. Do these additional instruments make economic and fiscal sense for large cities? Each of these is evaluated next.

## **A vehicle-registration levy**

An argument can be made in support of a city motor-vehicle-registration fee (this is a fixed charge on vehicle ownership). Fees could be based on features such as age and engine size — older and larger vehicles generally contribute more to pollution — or emissions, with lower-emission vehicles charged less than higher-emission vehicles. Location could also be a factor — cars in cities add more to pollution and to congestion — as could axle weight, with heavier vehicles causing substantially more damage to roads and requiring more costly roads to be built.

A vehicle tax is a crude instrument for handling traffic congestion because it does not vary with time of use, traffic volume, distance traveled, or the area in which vehicles travel (central city versus long distance out-of-city travel). On the other hand, it is a charge on those who use roads, at least in some capacity. It is also likely to have a greater impact on the rich than on the poor, because the latter have a lower rate of car ownership. Administration costs are relatively low if the charge is “piggybacked” onto the provincial charge; administration charges for Toronto’s personal vehicle tax (PVT) were estimated to be 1.5 per cent of gross revenues. To minimize tax avoidance, provincial requirements could be in place to prevent owners from registering their vehicles in a jurisdiction other than their principal place of residence.

Vehicle-registration fees are a fairly stable and predictable source of funding. The City of Toronto’s annual levy of \$60 on all passenger and light commercial vehicles was introduced by the city on Sept. 1, 2008 and terminated by the city on Jan. 1, 2011. In 2009, the PVT in Toronto yielded about \$50 million in revenues: \$51.7 million in gross revenue less \$0.8 million in fees and administration costs. The revenues, however, were not dedicated to transportation infrastructure, a weakness in gaining political acceptance for the PVT. Dedication of funds offers a number of advantages. It is consistent with the beneficiary principle in financing municipal services (those who use a service are those who pay), it facilitates long-term planning, it can prevent political abuse of funds, and it tends to boost public acceptability.<sup>4</sup> Securing public acceptance, as it turns out, is often a major barrier to the implementation of a new tax.

## **A municipal land-transfer tax**

A land-transfer tax (LTT) is levied at the time of sale of a property and is usually calculated as a percentage of the value of the property transferred. The tax, which must be paid before the transfer is registered, is similar to a sales tax payable by the purchaser and is calculated as a percentage of the purchase price. A number of variations on land-transfer taxes exist.

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<sup>4</sup> Harry Kitchen and Robin Lindsey, “Financing Roads and Public Transit in the Greater Toronto and Hamilton Area” (report for the Residential and Civil Construction Alliance of Ontario, 2013), available at [www.rccao.com](http://www.rccao.com).

For example, the tax rate sometimes increases with the value of the property; in some cases, taxes are higher on non-residents.

Provincial governments in many provinces have a land-transfer tax. Land-transfer taxes are only levied at the municipal level in Nova Scotia, Quebec, and in the City of Toronto. Toronto's land tax is piggybacked onto the provincial land-transfer tax.<sup>5</sup> In Nova Scotia, municipalities can levy a deed-transfer tax up to a rate of 1.5 per cent. Halifax Regional Municipality levies a deed-transfer tax at the maximum rate, but not all municipalities in Nova Scotia levy the tax. Municipalities in Manitoba are permitted to levy a land-transfer tax but do not currently do so.

A land-transfer tax is not a good tax for local governments. It bears no relationship to the benefits received for local services.<sup>6</sup> It imposes a burden on those who buy property while placing no burden on those who remain in their existing property. It provides an incentive for those who remain in their homes to demand municipal services, knowing that those residents who buy homes will disproportionately pay for those services.

Two empirical studies<sup>7</sup> on housing prices and household mobility in Toronto concluded that sales of single-family homes in the city fell by 16 per cent after the implementation of the municipal land-transfer tax (MLTT) with the most pronounced effect in areas with relatively low sales values, and concluded that homeowners chose to renovate rather than relocate.<sup>8</sup> It was also estimated that the MLTT resulted in reduced household mobility, with about 3,500 families that would have moved not doing so because of the existence of the tax.<sup>9</sup>

The MLLT impact of reduced house sales in Toronto coincided with an increase in house sales in the adjacent "905" area (a label connected to the telephone area code of the suburbs surrounding Toronto).<sup>10</sup> This shift in house sales was initially attributed to the implementation of the MLTT; however, a recent econometric study has concluded that any negative impact of the MLLT on sales after the tax is not statistically significant. It may have occurred for a variety of other reasons including the recent recession and subsequent recovery and a shift in demand to the 905 area driven by its less-expensive housing.<sup>11</sup>

What the tax does do, however, is provide a disincentive for people to move, thereby resulting in potential inflexibilities in the labour market and encouraging people to stay in properties of a size and location that they may not have otherwise chosen. In short,

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<sup>5</sup> Toronto's municipal LTT rate is 0.5 per cent on homes valued from \$0 to \$55,000; 1.0 per cent on homes valued from \$55,000 to \$400,000; and 2.0 per cent on homes in excess of \$400,000.

<sup>6</sup> Frank A. Clayton, *City of Toronto's Land Transfer Tax — Good, Bad or Merely Tolerable?*, Centre for Urban Research and Land Development (Toronto: Ryerson University, 2015).

<sup>7</sup> Benjamin Dachis, Gilles Duranton and Matthew Turner, *Sand in the Gears: Evaluating the Effects of Toronto's Land Transfer Tax* (Toronto: C.D. Howe Institute, 2008); and Benjamin Dachis, *Stuck in Place: The Effect of Land Transfer Taxes on Housing Transactions* (Toronto: C.D. Howe Institute, 2012).

<sup>8</sup> Dachis, *Stuck in*.

<sup>9</sup> Dachis, Duranton and Turner, *Sand in*.

<sup>10</sup> Dachis, *Stuck in*; and Murtaza Haider and Anwar Amar, *Did the Land Transfer Tax Affect Housing Sales in the Greater Toronto Area?* (presented at the Institute on Municipal Finance and Governance, Munk Centre, University of Toronto, Toronto, Ont. November 27, 2014), available at [http://munkschool.utoronto.ca/imfg/uploads/301/ltt\\_haider\\_anwar.pdf](http://munkschool.utoronto.ca/imfg/uploads/301/ltt_haider_anwar.pdf).

<sup>11</sup> Haider and Amar, *Did the*.

the economic cost of these reduced transactions has “cost billions of dollars of economic activity and thousands of jobs in the city since its inception. The revenue generated by the MLTT is far less than the economic cost caused by the new tax.”<sup>12</sup>

A land-transfer tax, if it is to be implemented, is best levied on as wide a geographical area as possible to eliminate the kind of relocation effect observed along the Toronto/905 border. Its actual implementation and administration is relatively easy and inexpensive as long as it is piggybacked onto the provincial land-transfer tax.

Since the tax is not related in any way to benefits received from municipal services, it is highly unfair in its distributional impact. At the same time, it is not related in any way to ability to pay because there is no direct relationship between homebuyers and their income or wealth.<sup>13</sup> In conclusion, recent empirical studies on the MLTT in Toronto have recommended that the LTT be eliminated and replaced with an equivalent increase in the municipal property tax.<sup>14</sup>

## Revenue bonds

Revenue bonds are the norm<sup>15</sup> in some countries (Italy and the United States, for example), but not in Canada. Here, Toronto is the only city that is permitted to use revenue bonds and it does so for a few, relatively small infrastructure projects, such as arenas,<sup>16</sup> whose services are funded by user fees that are adequate, predictable, and spread over the project’s life. Within the benefits-based model for financing city infrastructure, revenue bonds are an appropriate instrument. They are fair, efficient and accountable as long as those who benefit from the service pay for it through user fees or charges, with these revenues deposited into a separate account that is dedicated to repaying the borrowing costs.

## Tax incremental financing bonds

Tax increment financing (TIF) is an economic development tool widely used in the U.S. that was originally intended to encourage private investment in urban cores by stimulating downtown revitalization and encouraging brownfield remediation. This, it was argued, would make it easier for the core to compete with suburban and exurban areas, and it would lead to an improved urban quality of life and future tax revenues.<sup>17</sup> TIFs cover all properties within a designated area rather than individual properties, such as those covered by a value-

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<sup>12</sup> Altus Group Economic Consulting, *Economic Implications of the Municipal Land-transfer tax in Toronto* (prepared for the Ontario Real Estate board, Toronto, 2014), ii.

<sup>13</sup> Clayton, *City of*.

<sup>14</sup> *ibid.*; and Dachis, *Stuck in*.

<sup>15</sup> The norm in Canada is general obligation bonds.

<sup>16</sup> City of Toronto, “Authority to Issue an Amortizing Revenue Bond for the Leaside Memorial Community Gardens Arena Board of Management,” Staff Report (December 5, 2013), <http://www.toronto.ca/legdocs/mmis/2013/db/bgrd/backgroundfile-64422.pdf>.

<sup>17</sup> Olaf Merk et al., “Financing Green Urban Infrastructure,” OECD Regional Development Working Papers 2012/10 (OECD Publishing, 2012), <http://dc.doi.org/10.1787/5k92p0c6j6r0-en>.

capture levy, or a series of properties along a city street on which a special assessment is levied to fund the replacement costs for infrastructure that benefits these properties.

TIFs work in the following way. For a specific period of time (long enough to recover all costs of public funds used to redevelop the property), property tax revenue from the designated area is divided into two categories. Taxes based on property values assessed before redevelopment are retained by the municipality for general use. Taxes based on the increased assessed values arising from redevelopment are deposited in a special increment fund, with revenue from this fund used to repay bonds that have been issued to finance public improvements in the redeveloped area. In other words, increases in property tax revenue from the redevelopment of an area are dedicated to financing public improvements in that area.

TIFs are widely used in the United States but used only sparingly in Canada. In Manitoba, cities are permitted to use TIFs, but do not currently do so. Legislation in Alberta permits municipalities to use a form of TIF known as the “community revitalization levy.” This permits municipalities to impose a levy “in respect of the incremental assessed value of property in a community revitalization levy area to raise revenue to be used toward the payment of infrastructure and other costs associated with the redevelopment of property in the community revitalization levy area.” Municipalities issue debentures to cover the costs of redevelopment and use the taxes collected on the increased assessed value to repay the debenture. As an example, a community revitalization levy is applied in approximately half of Calgary’s downtown to finance infrastructure costs associated with its East Village redevelopment. In Ontario, American-style TIFs are currently allowed for only two pilot projects<sup>18</sup> under the *Tax Increment Financing Act*.

Supporters of TIFs argue that, in using them, there is no transfer of funds from a local government to subsidize a business, nor any transfer of tax dollars from one business to another, because development is financed from increases in the tax revenue that it generates. Unlike bonuses or tax abatements where taxes are reduced or forgiven on a particular property, property owners in a tax increment district (TID) incur the same local tax rate as property owners outside the district. Preferential treatment is granted only in that taxes from the increased assessment base of the TID are dedicated to financing local improvements. Dedicated tax dollars reduce the risk and uncertainty facing the private sector. If used to stimulate downtown development (infilling) or brownfield remediation, TIFs could discourage urban sprawl.

The use of TIFs in the U.S. has generated considerable criticism. They were originally intended for “blighted” areas in urban cores where redevelopment would otherwise not take place “but for” the incentive. In recent years, however, the requirement that the area be “blighted” has often been ignored and TIFs have been used in more affluent neighbourhoods and open spaces, including farmlands, where there is greater potential for property value increases and higher tax revenues.<sup>19</sup> The “but for” test has also been

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<sup>18</sup> The subway expansion in York Region and the West Don Lands brownfield redevelopment initiative, part of the revitalization of Toronto’s waterfront.

<sup>19</sup> Joan Youngman, *TIF at a Turning Point: Defining Debt Down* (Cambridge, Mass: Lincoln Institute on Land Policy, 2011).

compromised because many developments would have occurred anyway.<sup>20</sup> Finally, TIFs target funds to a designated area and this targeting may be at the expense of areas on the periphery of the TIF district or at the expense of overall municipal growth.

### **C. CHARTER STATUS AND CITY FINANCING — A MYTH?**

With the exception of Toronto, which has access to a range of relatively minor taxes and additional borrowing instruments, city-charter status (or special-legislation status) in Canada appears to have little to do with giving cities access to additional “significant” taxes or much more fiscal autonomy. Why is this so? While the answer is not clear, a couple of observations may be made. Provinces are reluctant to share their provincial tax bases with cities. This is somewhat ironic because the same provincial governments (except for that of Newfoundland and Labrador) share the property tax with municipalities, with the provincial portion supposedly used to fund a portion of provincial public schooling costs.<sup>21</sup> As well, it may be that cities trying to secure charter status want a form of revenue sharing as opposed to access to new taxes with responsibility for setting local tax rates. Raising revenue under the former is akin to a grant for which the provinces take the heat if it leads to higher provincial taxes, while revenue under the latter is similar to revenue from the property tax, for which local politicians take the heat in setting tax rates.

Even in the case of Toronto, which has been granted more tax choices, there has been little interest in adopting new ones, at least not from the menu provided to it. Why is this so? It may be attributed to a general dislike of the new options because of their impact on economic activity or their inability to generate significant revenues. More likely, however, local politicians do not want to take responsibility for justifying and defending the imposition of new (more) taxes on existing taxpayers. This may partially explain why the land-transfer tax continues — it is easier to tax new residents who will not vote until sometime in the future than to tax existing residents who vote now. Nor has there been much of an appetite for borrowing to fund much-needed infrastructure, even though cities, by and large, have considerable borrowing capacity. Instead, Canadian cities continue to solicit more and more grants (from provincial and federal governments) for funding infrastructure whose benefits accrue primarily to the local community.

### **D. CHARTER STATUS AND CITY FINANCING — A SOLUTION?**

Could charter status be a solution for financing city services? It might be, but it might not be. It depends on what is in the charter. If it permits cities to access new taxes that are appropriate for financing city services, and if they use them, fiscal sustainability and local autonomy could be improved. If it does not, the charter is not the solution to fiscal concerns. Furthermore, it must be emphasized that charter status need not be a prerequisite for giving

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<sup>20</sup> Greg LeRoy, “Greenfields and Sprawl: How an incentive created to alleviate slums has come to subsidize upscale malls and New Urbanist developments,” *Planning and Environmental Law* 60, 2 (2008): 3-11; and Youngman, *TIF at*.

<sup>21</sup> For more detail, see Harry Kitchen and Almos Tassonyi, “Municipal taxes and user fees,” in *Tax Policy in Canada*, ed. Heather Kerr, Ken McKenzie and Jack Mintz (Toronto: Canadian Tax Foundation, 2012), chapter 9.

cities access to new taxes, although it could be. Arguments for new taxes are much wider-ranging and apply equally to all cities regardless of status. Indeed, growing concern about the fiscal plight of cities and the provincial and federal response to it — or lack thereof — has prompted a discussion about whether cities should have access to new taxes. In particular, is there a role for new taxes? Which taxes should be considered? Should they be restricted to cities? Who should set tax rates or charges? Should revenues be earmarked? Each of these is discussed below.

## D.1 Is there a role for new taxes?

Recently, it has been argued that the property tax is the only tax needed by cities to finance municipal services in Alberta. Indeed, the argument continues, if the education portion of the property tax were eliminated, cities would have more than enough tax room to finance their services now and well into the future.<sup>22</sup> A recent study on the City of Toronto's finances noted that property tax revenues have grown less than inflation since 2000 and that the tax burden per household has been falling over this time.<sup>23</sup> A more recently published study on the Greater Toronto Area<sup>24</sup> concluded that there is room to increase property taxes in most municipalities in the GTA. A quick calculation of effective tax rates (property taxes as a percentage of the assessment base) for the 10 largest cities in Ontario over the past four years shows a slight decrease in the overall effective tax rate in all but one city.<sup>25</sup> In reality, there is no question that the property tax could generate more revenue than it currently does in virtually every city in Canada — politicians could simply raise the tax rate. Furthermore, there is no solid evidence to suggest that raising the tax rate would lead to serious financial constraints, bankruptcy, or revenue loss.

The real question, it seems to me, is not whether the property tax is adequate or inadequate, but whether this is the best tax for funding all municipal services. This is not an attempt to diminish the importance of the property tax. Indeed, the property tax is important, just as it is important to consider giving cities and metropolitan areas access to a range of new taxes so that they can choose the best combination for funding the wide range of services they offer. This range has expanded over the past two or three decades. Provincial offloading of expenditure responsibilities, additional services for an aging population, and the fact that the majority of infrastructure assets, their construction, maintenance and expansion have become municipal responsibilities, which has contributed to and will continue to contribute to the increased burden on the municipal sector.

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<sup>22</sup> Mel McMillan and Bev Dahlby, "Do Local Governments Need Alternative Sources of Tax Revenue? An Assessment of the Options for Alberta Cities," University of Calgary School of Public Policy Research Paper 7, 26 (Calgary: University of Calgary, 2014).

<sup>23</sup> Enid Slack and André Côté, "Is Toronto Fiscally Healthy? A Check-up on the City's Finances," *IMFG Perspectives* 7 (Toronto: Institute of Municipal Finance and Governance, University of Toronto, 2014).

<sup>24</sup> Almos Tassonyi, Richard M. Bird and Enid Slack, "Can GTA Municipalities Raise Property Taxes? An Analysis of Tax Competition and Revenue Hills," *IMFG Papers on Municipal Finance and Government* No. 20 (Toronto: University of Toronto, 2015).

<sup>25</sup> Calculated from data in the annual *Municipal Financial Information Returns*, Provincial Ministry of Municipal Affairs and Housing, Toronto, Ont.

Arguments have been made supporting a mix of taxes for large cities and metropolitan areas in Canada<sup>26</sup> as a solution to their revenue needs. This is no different than the current situation in many other countries. Additional taxes would give cities more flexibility in responding to local conditions such as changes in the economy, evolving demographics and expenditure needs, changes in the political climate, and other factors.<sup>27</sup> It would make the local tax structure more flexible, permitting elected politicians to choose taxes that best fit local conditions and circumstances. It would also mean that municipal governments would not have to implement large property tax increases. This is especially beneficial for taxpayers who are asset rich but income poor and who would otherwise have difficulty meeting their property tax obligations.

## D.2 Which taxes should be considered?

A few possibilities are appropriate. The choice should be driven by the services that are to be funded by these new revenues. For large cities and metropolitan areas in Canada, expenditures on roads and transit account for a large percentage of municipal spending (tables 2 and 3 above).<sup>28</sup> Transportation mobility and infrastructure spending is becoming increasingly more and more important in Canada's large cities and metropolitan areas, and it is in those places where much of Canada's economic activity is generated. Businesses engaged in national and international activities must have access to a highly qualified workforce, business services, *transportation*, and communications networks. The global economy is ever expanding and increasingly competitive and it is critical that Canada's large cities and metropolitan areas have effective and efficient public transit and road systems.<sup>29</sup> Increasing traffic congestion and pollution are growing concerns. If bridges, highways and public transit systems are not maintained, liability will also become an issue.

At the moment, motor vehicle usage is inefficiently priced. Motor vehicles occupy valuable space both on the road and while parked. Neither road usage nor parking space is currently rationed with effective pricing structures. Without efficient prices, users cannot tell how much the service actually costs. Users lack incentives to make efficient decisions about how often to use the service, where to live and work, and so on. Inefficient pricing can induce over-investment where the service is underpriced, and under-investment where it is overpriced.<sup>30</sup> To resolve this deficiency, the range of city taxes/charges needs to be expanded. Dedicated fuel taxes and motor-vehicle-registration fees could be implemented in the near term. These would be relatively easy to implement, inexpensive to operate and

<sup>26</sup> New taxes, it must be noted, would require provincial approval and possibly new legislation.

<sup>27</sup> Enid Slack, "The Politics of the Property Tax," in *A Primer on Property Tax Administration and Policy*, First Edition, ed. William J. McCluskey, Gary C. Cornia and Lawrence C. Walters (John Wiley & Sons Ltd., 2013), chapter 3; Enid Slack, "The Property Tax in Theory and Practice," IMFG Papers on Municipal Finance and Governance No. 2 (Toronto: University of Toronto, 2011); Harry Kitchen, "Principles and Best Practices for Funding, Financing, and Cost Sharing Metro Vancouver's Municipal Services," (a discussion paper for Metro Vancouver, 2010); and Harry Kitchen and Enid Slack, "Special Study: New Finance Options for Municipal Governments," *Canadian Tax Journal* 51, 6 (2003): 2215-2275.

<sup>28</sup> Vancouver's share of the budget devoted to transportation is relatively small because Translink (a metro-wide agency) is responsible for most transportation expenditures.

<sup>29</sup> Conference Board of Canada, "Connecting Jobs and People Exploring the Wider Benefits of Urban Transportation Investments" (August 2011), <http://www.conferenceboard.ca/e-Library/abstract.aspx?did=4374>.

<sup>30</sup> Kitchen and Lindsey, "Financing Roads"; and Philip Bazel and Jack Mintz, "The free ride is over: why citizens must start paying for much needed infrastructure," University of Calgary School of Public Policy Research Paper 7, 14 (May 2014).

could satisfy the principles for an efficient, fair, accountable, and transparent local tax. Cities could set their local tax rate with the tax piggybacked onto the provincial tax, the revenue collected by the province and remitted to cities.

In the longer term, consideration should be given to establishing more efficient parking fees and road-pricing charges.<sup>31</sup> On this latter point, it is interesting to note the increased attention that the media, a handful of local politicians, public policy analysts, academic and consulting reports are now devoting to a discussion of pricing as an effective instrument for helping resolve the congestion nightmare and to provide valuable funds for partially resolving it. The technology is available; what is lacking is the political will.

For services that provide collective benefits<sup>32</sup> to the local community, a personal income tax<sup>33</sup> is justifiable. The simplest and easiest way of implementing a local variant of this tax would be to piggyback onto the provincial personal income tax. Here, the taxing city would set its tax rate — one or two per cent, for example — and apply this to either the taxpayers' assessed provincial income tax base or as a surtax on provincial income taxes payable. This system would be relatively inexpensive to administer because the province would collect the revenue and periodically remit the local share to the city. The downside is that the city would have no control over the tax base and may have to wait for tax remittances that might only occur periodically, but this would be a small price to pay when compared with the administrative costs of setting up its own personal income tax system.

If a city were permitted to adopt a municipal income tax, a decision would have to be made as to whether or not it was to be residence-based or payroll-based: For a residence-based income tax, one additional line could be included on the provincial personal income tax form. It could follow the line where taxpayers report their provincial income tax liability. All taxpayers with postal codes that are part of the taxing municipality's jurisdiction would be required to complete this line by multiplying their provincial income tax liability by one per cent (or whatever rate is determined by city council) and reporting the dollar value on this line. The province could collect the revenue and remit it to the city.

For a tax on payrolls or earnings, each employer within the city would be required to apply a surtax (the rate set by the city council) to provincial income taxes deducted from all employees. This tax would not be on all income received by taxpayers, only on wage and salary income (hence, it is known as a tax on payrolls). The tax would be paid by employees who are resident in the city as well as those who live outside the city but work in it. The revenue would be collected along with provincial income taxes and remitted to the city.

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<sup>31</sup> Kitchen and Lindsey, "Financing Roads."

<sup>32</sup> These are services that are available for everyone even though not everyone uses them. Here, it is not possible or easy to identify and charge individual beneficiaries and that is why they should be funded by a local tax on everyone.

<sup>33</sup> A municipal corporate income tax is not considered for some important reasons. First, corporate income taxes have fallen in major trading countries so there does not appear to be any justification for making it more costly for Canadian corporations to compete. Second, taxing mobile corporate capital and corporate profits encourages firms to shift their investments and profits to lower-taxed jurisdictions: Bev Dahlby, "Reforming the Tax Mix in Canada," University of Calgary School of Public Policy Research Paper 5, 14 (2012). Furthermore, taxes based on a mobile tax base are not good candidates for local taxation. Third, property taxes on the commercial/ industrial sector already overtax business and thus, there is no reason for an additional tax burden that bears no relationship to the cost of municipal services consumed.



A major advantage of the payroll-based tax is that it captures revenue from commuters who work in the city and use city services, but live outside the city and might not otherwise contribute to the cost of the services used. A shortcoming of the residence and payroll-based income tax is that it does not apply to visitors; hence, visitors do not contribute to the cost of services that they use.<sup>34</sup>

### D.3 Should these new taxes be restricted to cities?

Some cities in Canada are large, single-tier structures, but most exist as two-tier structures: an upper tier that is metropolitan, regional, district or county, and the lower tier that is a city. The distinction is important when it comes to giving cities access to new taxes. Distortions in location, employment and cross-border-shopping decisions are likely to be minimized if the tax is levied on a metropolitan or region-wide basis rather than at a city level (unless the city is large), especially if the city is part of a large regional conglomeration of municipalities, such as the Greater Toronto and Hamilton Area (GTHA) or Metro Vancouver or the metropolitan areas around Montreal or Edmonton. The larger the taxing jurisdiction, the less likelihood there is for cross-border relocation, employment and shopping behaviour in response to the tax. In addition, a tax at a region-wide level makes sense because municipalities that are part of a regional area have become more integrated over the past two or three decades.

### D.4 Who should set tax rates?

Setting local tax rates is different than revenue sharing. For some time, cities in Canada and their municipal associations have been asking for some form of revenue sharing with senior levels of government. At the moment, provincial/municipal revenue sharing of personal and corporate income taxes exists in Manitoba.<sup>35</sup> Other examples include the sharing of provincial fuel-tax revenue in a few Canadian cities and regions and the sharing of federal gas-tax revenue with Canadian municipalities. Revenue sharing, while popular with municipalities, does not meet the criteria of autonomy, accountability, and transparency. International experience tells us that municipal governments operate with more fiscal discipline and are more responsible, efficient and accountable when they are required to fund their spending from locally generated revenues.<sup>36</sup> Additional autonomy can also be achieved if municipal governments are free to establish and determine their local tax base. The high administrative costs of doing so, however, generally argue against it.

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<sup>34</sup> For a more detailed discussion see Harry Kitchen and Enid Slack's forthcoming IMFG paper, scheduled for release in late 2015 or early 2016.

<sup>35</sup> Through the Building Manitoba Fund, the province shares one-seventh of provincial sales tax revenues, or 4.15 per cent of provincial income tax, and two cents per litre of gasoline tax and one cent per litre of diesel fuel tax (whichever is greater) for infrastructure and transit costs. Most of this funding is conditional, provided through various grant programs targeting infrastructure such as roads and bridges, water and sewer infrastructure, recreation facilities, etc.

<sup>36</sup> Richard M. Bird and Roy Bahl, "Subnational Taxes in Developing Countries: The Way Forward," Institute for International Business Paper No. 16 (Toronto: Joseph L. Rotman School of Management, University of Toronto, 2008): 6; and Richard M. Bird, "Subnational Taxation in Developing Countries: A Review of the Literature," *Journal of International Commerce, Economics, and Policy* 2, 1 (2011):139-161.

## D.5 Should revenues be earmarked?

Implementing new taxes to pay for specific services means that funds will be dedicated to the financing of specific services. There are four main arguments for dedication, however: it is consistent with the beneficiary principle, it facilitates long-term planning, it can prevent political abuse of funds, and it tends to boost public acceptability. Gaining public acceptance, as it turns out, is often the remaining barrier to the implementation of new taxes in most jurisdictions; therefore dedication of revenues is generally supported if new taxes are to be considered.

## E. SUMMARY

With few exceptions, charter cities in Canada have the same spending responsibilities and revenue-raising tools as non-charter cities. This leads to the observation that the advantage of charter status has largely been a myth when it comes to cities accessing and implementing new taxes, an outcome that may be attributed to action or inaction by provinces and cities. First and foremost, provinces have been unwilling to give cities access to new taxes that are appropriate for funding the wide range of services for which they are currently responsible. Second, even where a city (Toronto, in particular) has been granted additional taxation and borrowing powers, there has been a local reluctance to expand the revenue base in any substantial way.

Whether or not charter status could be a solution for financing city services would depend on what is in the charter. If it permits cities to access new taxes that are appropriate for financing city services and if cities adopt them, fiscal sustainability and local autonomy would be improved. If it does not, the charter is not the solution to fiscal shortfalls. In any case, charter status need not be a prerequisite for giving cities access to new taxes, although it could be. The vast range of services for which cities are now responsible suggests that there are strong arguments in support of permitting some benefit-based taxes and charges for services where beneficiaries can be identified, and even a city personal income tax piggybacked onto the provincial income tax for those services that provide collective benefits to the local community. At the same time, it is critical that cities set their own tax rate and, where possible, earmark the revenues for specific services.

### **About the Author**

**Harry Kitchen** is the Professor Emeritus in the economics department at Trent University. Over the past 20 years, he has completed more than 100 articles, reports, studies and books on issues relating to local government expenditures, finance, structure and governance in Canada. Additionally, he has served as a consultant or advisor for a number of municipal and provincial governments in Canada, the federal government, foreign governments in Russia and China, and some private sector institutions. In 2013, Mr. Kitchen was awarded a Queens Diamond Jubilee medal for policy analysis and research contributions to municipal finance, structure and governance in Canada.

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