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Toronto's Taxing Question

Options to Improve the City's Revenue Health

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Introduction

With a new mayor at the helm, the City of Toronto's 2015 budget season is about to begin.

After four years of strife and rifts over budget decisions, the 2015 city budget will set the tone for the new administration, the new council, and for a city of residents looking to see a more united front from their elected representatives. It is an opportunity to change course in both style and substance. It is an opportunity to begin to address the problems and issues that have long been neglected; issues that can make or break a city the size and breadth of Toronto: homelessness, increasing income inequality, geographic and racial divides, and the problem that frustrates every Torontonian — traffic congestion.

There was little discussion of city finances during the 2014 municipal election campaign, nor of how to pay for the services that everyone needs. The primary focus in the campaign was on transit. The gridlock that resulted from years of neglect and bitter division over the public transit file at City Hall has become the symbol of what happens when a city this size remains so divided, and why a "one Toronto" unification strategy is badly needed.

By default, the new mayor has inherited a legacy of underinvestment by all three levels of government in infrastructure and services that make a difference in Torontonians' quality of life. That underinvestment has contributed to the city growing further apart. It has tolerated worsening income inequality that has divided Toronto into three cities — Toronto the rich, Toronto the poor, and a shrinking middle class.

No matter what the source of the underinvestment, the problems of income inequality and persistent poverty inevitably land on the doorstep of the municipal government. That's where front line services are delivered, whether it's in the form of social assistance, child care subsidies, public health care supports, or policing. And, because cities are closest to these problems, they have a responsibility and an opportunity to step up and show leadership in making the investments that the city needs.

This paper will look at the tools the new council and mayor already have at their disposal to begin rebuilding our city immediately, starting with the 2015 budget. These include making fuller use of the property tax, and using council's unique powers under the *City of Toronto Act* (COTA) to broaden the city's revenue base.

Context

In 2014, the City of Toronto's capital budget was approved at $2.8 billion, while the operating budget was four times as large, at $11.2 billion (including the tax and rate supported budgets).

The differences between the two budgets, of course, do not end there. While the city can borrow to fund capital spending, it must balance the operating budget. Each and every year, regardless of unexpected events like extreme weather, operating expenditures must be matched by revenues intake.

While there was a lively debate on newly elected Mayor John Tory's proposal to fund subway expansion through tax increment financing, there was little attention on how to pay, on an ongoing basis, for the services that Torontonians rely on. The new mayor has said he will look for 'efficiencies' in public spending.[1] While that's a laudable goal, the city just spent the past four years on a wild goose chase for gravy and had a hard time finding it. A city-funded KPMG report revealed there are few services the city could actually cut: it ranked 90 per cent of services as core — either required by legislation or essential to the effective functioning of government.[2] The reality is that city management is accustomed to squeezing every dollar.

The new mayor has said he will seek further funding support from the provincial and federal governments. That's a necessary step, because both senior levels of government have greater taxation options at their disposal and both should provide support to Toronto's growing social and economic challenges. But a cap-in-hand strategy isn't the only option at the mayor's disposal. To ask senior levels of government for help requires leadership from council, too.

It's time to look at the elephant in the room: revenue.

Toronto's Revenue Problem

Both the city manager and the Institute for Municipal Finance and Governance (IMFG) have made it clear that the city doesn't have a spending problem, it has a revenue problem.[3,4] The IMFG took an in-depth look at Toronto's finances and found that Toronto's operating expenditures, per household, were virtually unchanged between 2000 and 2012, when adjusted for inflation. It showed that transportation spending rose as a share of operating spending, going from 21 per cent to 28 per cent. While police and fire services maintained a constant share, the share for social and family services fell from 27 per cent to 20 per cent of operating spending. Stagnant real spending, with an increasing share going to transportation, clearly hasn't resolved gridlock, nor the mounting social problems that the city faces.

Property taxes are the city's largest revenue source. The IMFG report also showed that real property taxes paid per household fell by nearly 15 per cent between 2001 and 2012. As property taxes have increased by less than inflation and population growth, the city's capacity to maintain vital public services is actually decreasing.

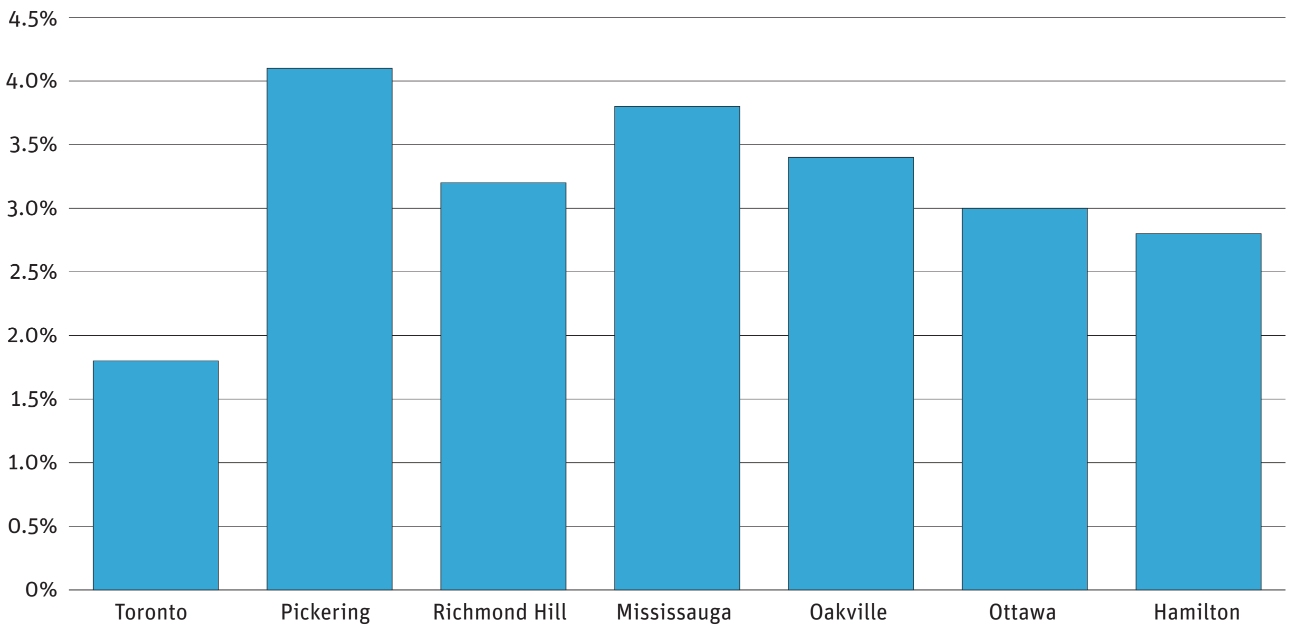
Finally, Toronto's rate of increase in property taxes was lower than in neighbouring jurisdictions as *Figure 1* shows.

Given this reality, the city would be wise to re-examine Mayor Tory's commitment to property tax increases below inflation.

As the need for city services continues to grow, Toronto's new government needs to consider all the revenue tools at its disposal to meet these needs.

There is much lamenting that Toronto does not have all the taxation powers of large U.S. cities, including sales and income taxes. That is true and it should be corrected. However, that is a long-term project. The city can take immediate action in its 2015 budget to increase revenues to pay for needed services. Further, if the city makes fuller use of the taxation powers already

FIGURE 1 Average Annual Total Property Tax Rate Increase Comparison, 2004–13



Source Pennachetti, J. (2014). Toronto: Looking Forward 2014-2018 Investing for the Future. Presentation at IMFG.

within its grasp, it would increase its credibility in asking for increased transfers or taxation powers from senior levels of government.

These actions include bringing in new taxes that are possible under the COTA and catching up on the lost property tax revenues that resulted from the last administration's budgets. There is no time to lose. The previous administration harmed the city's finances by allowing property tax revenues to fall behind inflation and population growth and by eliminating the vehicle registration tax. As a result, the city finds itself falling behind in its ability to fund public services.

Unleashing the Power of the City of Toronto Act

The new administration could use the potential of the COTA.[5] This 2006 Act expanded the powers available to the city, including taxation powers that are not available to other Ontario municipalities. Some of these have been implemented by previous administrations: the land transfer tax (LTT), the billboard tax, and the vehicle registration tax. The LTT has become an important source of revenue to the city. It is estimated to bring close to $360 million into the city's coffers in 2014.[6] The billboard tax, or the third party sign tax, brings in about $10 million annually.[7] Despite its revenue raising potential, one of the first acts of the Ford administration was to abandon the vehicle registration tax. That political decision came at a fiscal cost: the vehicle registration tax was estimated to raise $64 million annually. [8] That's $64 million that the city isn't collecting. And it's contributing to the perennial sense of crisis during city budget season.

Meanwhile, the expanded powers under the Act have not been fully utilized by Toronto city council. In 2007, the city published revenue estimates for a range of taxes that were newly available to the city.[9] We updated those estimates to start a conversation about ways in which we can pay for the public services that benefit all Torontonians — from public libraries to more affordable child care options.

Table 1 shows revenue estimates for six different measures:

While the COTA prohibits the city from implementing sales taxes, it includes exemptions for the following: tax on admission to a place of amusement; tax on purchase of liquor for use or consumption; tax on production of beer or wine in a brewing facility for use or consumption; and tax on the purchase of tobacco for use or consumption. We have updated revenue estimates for the following sales taxes based on those exemptions:

- A 5 per cent tax on sales of cigarettes sold by retailers;
- A 5 per cent tax on alcohol sales at LCBOs, Beer Stores, agency stores, wine stores, breweries; and
- A 5 per cent entertainment tax on movie admissions, live sports events and live performing arts events.

The city also provided estimates for the revenues from:

- Road tolls on the Don Valley Parkway and Gardiner Expressway at $0.10 per kilometre (km) for peak hours and at $0.05 per km for non-peak hours;
- A $100 flat rate tax on non-residential parking spaces. This estimate was for parking spaces for a small area of the central business district of downtown Toronto. It was updated by applying the tax to more recent estimates of the number of parking spaces throughout the city; and

TABLE 1 Revenue Estimates

Potential Taxation Measures	Descriptions	Rate	Estimated Revenues ($ Millions)
Tobacco Tax	A sales tax on retail purchases of cigarettes	Tax at 5%	30
Alcoholic Beverage Tax	A sales tax on alcoholic beverages sold at the LCBO, Beer Store, agency stores, breweries, and wineries	Tax at 5%	77
Entertainment Tax	A tax on movie admissions, live sports, and live performing arts	Tax at 5%	18
Road Tolls	A road toll of $0.10 per km for peak weekday hours and $0.05 for non-peak hours on the Gardiner Expressway and the Don Valley Parkway	.10 per km for peak hours; .05 per km for non-peak hours	78
Tax on non-residential parking spaces	Flat rate tax on parking lots by imputed number of spaces	$100 per parking space per year	175
Vehicle Registration Tax	Flat tax on all ownership registrations or licenses issued	Tax at $60	66

Source See Appendix A

- We estimated the revenues that would result from a re-introduction of the vehicle registration tax, which was eliminated in 2010.

The city provided a range of estimates for revenues from taxes on cigarettes, alcohol, entertainment, and non-residential parking spaces based on a broad range of tax rates. We limited our update to the middle range of those rates. *Table 1* is a conservative estimate of potential revenues. The estimates take into account administrative costs, price elasticities, and tax avoidance elasticities. Some of these taxes would be easier to implement than others; some would have higher administrative costs than others. These taxes have differing revenue-raising capacity: from $18 million for the entertainment tax to $175 million for the parking levy. (See Appendix A for more details on methodology.)

The above estimates provide the mayor and council with a menu of new revenue sources that hold the potential to raise more than $400 million annually. These revenue sources have the potential to make a meaningful contribution to meeting the needs for city services.

Property Taxes

Property taxes don't grow with the economy in the way sales or income taxes do. Politicians at other levels of government do not have to adjust tax rates every year to keep up with inflation, but municipal politicians do. When real estate prices increase, they do not automatically increase the total amount of revenue collected by the city; they just redistribute revenues among properties. In the 2014 budget, the former city council increased property tax revenues by 1.46 per cent.[10] Once again, this was an increase well below the 3 per cent needed to keep up with inflation and population growth. Just to maintain Toronto's existing city services, revenues would have to keep up with the increasing number of Torontonians who access them, and with the increase in the cost of maintaining those services. A property tax increase that is less than half the rate of rising service costs means that Toronto's most reliable source of revenue lags far behind the city's actual needs.

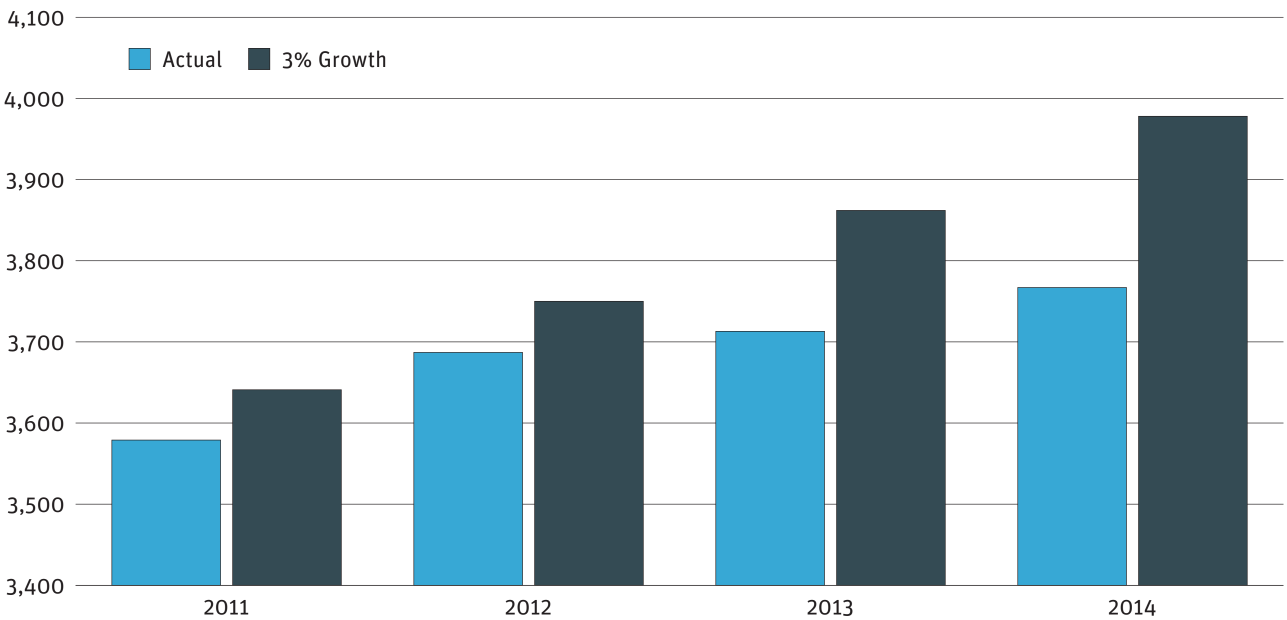
This approach is no longer sustainable. Everything from more extreme weather, to gridlocked transportation systems, to over-subscribed recreation programs tells us that Toronto needs more city services, not fewer.

Each year's tax freeze, or below inflation increase, has a cumulative constraining impact on future years' budgets. *Figure 2* compares where revenues would have been with a modest 3 per cent increase in property tax revenues each year to keep up with inflation and population growth, and where they are now. By 2014, the city's annual property tax revenues could have been $200 million higher than it is today. The cumulative revenue loss over the past four years was almost half a billion dollars.

Mayor Tory and the new council have an opportunity to start this administration with a clear break from the recent past. They can acknowledge how valuable Toronto public services are for everyone and they can leverage revenue increases needed to pay for these services.

Mayor Tory has stated that Toronto is a really good city, but not a great one.[11] With improved public services, affordable housing, and connected, reliable transportation networks, it can be a great city. Becoming a great city will require more revenue than the City of Toronto is currently collecting. The moment has come for city council to exercise the revenue options they have within their grasp: catch up on lost property tax revenues and ensure that they grow with the need for city services, as well as leverage the existing revenue raising powers under the COTA more fully.

FIGURE 2 Property Tax Revenue Actual vs. Constant Real per Capita



Source City of Toronto budgets and authors' calculations.

Conclusion

This brief overview itemizes a menu of tax options the city has within its grasp to resolve pressures on the 2015 budget.

It shows that Toronto has not fully utilized the tax room it has at its disposal within the City of Toronto Act, enacted in 2007. The total tax room from a range of tax measures is more than $400 million annually.

It also shows the cost of the Ford administration experiment with tax reductions amounts to a cumulative loss of almost $500 million in untapped property taxes over a four-year period.

City council has the power to leverage greater revenue in order to improve and enhance public service needs in Toronto. Its problem isn't spending — Toronto has a revenue problem. But the solutions are within reach.

Appendix A

Methodology

THIS PAPER UPDATES revenue estimates from the City of Toronto Corporate Finance Division.[12] These estimates accounted for administrative costs, price elasticities, and tax avoidance elasticities. The details of these estimates are provided in the document. In most cases, the revenue estimates have been updated by applying the growth rate of the underlying tax base or a proxy.

Alcohol

The revenue estimates for a sales tax on alcoholic beverages sold at LCBO, beer stores, agency stores, wine stores, breweries, and wineries were inflated using the growth rate in sales of Ontario alcoholic beverages from 2008 to 2013 from Statistics Canada Table 183-0015.

Tobacco

The revenue estimates for a sales tax on cigarettes were updated using the growth rate in cigarette sales in Ontario between 2008 and 2012 from Health Canada data. Retrieved from Health Canada Wholesale Sales Data — Cigarette Sales in Ontario.

Entertainment

The revenue estimates for a tax on movie admissions, live sporting events, and live performing arts were updated using the growth rate in Ontario expenditures on recreational and sporting, cinemas and other cultural services between 2008 and 2013 from Statistics Canada Table 384-0041

Road Tolls

The revenue estimates for road tolls on the Don Valley Parkway and Gardiner Expressway of $0.10 per kilometre for peak hours and $0.05 for km for non-peak hours was updated using the growth in traffic on these two expressways between 2008 and 2012 obtained in private communications with City staff.

Vehicle Registration

This revenue estimate used City of Toronto estimate of lost revenue in 2011 from the cancellation of the vehicle registration tax, and inflated it by the growth in road motor vehicle registrations in Ontario between 2011 and 2013 in Statistics Canada Table 405-0004.

Parking

The estimate for parking tax revenues was updated using more recent, and more expansive, estimates of parking spaces in Toronto. The estimate for parking tax revenues in the 2007 paper on non-residential parking spaces was based on the tax being applied only in the central district of downtown Toronto. A Toronto Parking Authority discussion paper based revenue estimates on all non-residential spaces in Toronto.[13] Metrolinx provided an estimate of GTHA parking spaces.[14] These were disputed by Altus Consulting, which provided a smaller estimate along with the share of the parking spaces that were in the City of Toronto.[15] The smaller estimate was used for the revenue estimates in this paper. And, in line with the estimates by the City of Toronto, 3 per cent administration cost was taken off of these estimates.

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