Faculty of Community Services

Centre for Urban Research and Land Development

Making Toronto’s Tax System Better - Repeal the Land Transfer Tax

Issue and Questions Addressed

The Land Transfer Tax (LTT) imposed by the City of Toronto in early 2008 is controversial with the real estate industry fervently pleading for its repeal. These pleas have been supported by economic critiques that stress the adverse economic impacts associated with the tax. In contrast, with the tax generating a considerable revenue stream – a record $432 million in 2014 – City Council and its staff advisors are reluctant to tinker with the tax, let alone eliminate it. Replacing the LTT with an increase in the property tax is not compatible with the Mayor Tory’s election promise of not increasing property taxes by more than the inflation rate.

This commentary gathers and assesses information to provide insight into two questions: How should Toronto residents regard the LTT – as a good tax, a bad tax, or simply a tolerable tax? And would the city’s tax system be improved by dropping the LTT and replacing foregone revenues with higher property taxes?

The analysis concludes that while Toronto’s land transfer tax is tolerable, it should be replaced over time by higher property taxes. The city’s local taxation system would be made significantly fairer and future tax revenue more stable if the LTT is dropped and the revenue foregone is made up by higher property taxes.

The analysis which follows is limited to the single-family residence sector of the property market.[2] Single-family residences include single- and semi-detached houses, townhouses and condominium apartments.

The LTT is borne largely by the purchasers of properties

The city’s LTT is levied on the purchasers of properties located in Toronto. Considerations of economic impact and taxpayer equity, however, hinge on who ultimately pays the tax – buyers of properties, sellers of properties, or whether there is a sharing of the burden between buyers and sellers.

1. This policy commentary is based on a forthcoming CUR research report, City of Toronto’s Land Transfer Tax – Good, Bad or Merely Tolerable?, a report authored by Dr. Frank A. Clayton, Senior Research Fellow, CUR. The opinions expressed are those of the author only and do not necessarily represent the opinion and views of either CUR or Ryerson University.

2. The taxation of commercial and industrial real estate purchases is an important issue in its own right. Under the city’s LTT, purchases of rental apartment and townhouse projects are treated as commercial properties.

If sale prices are unaffected by the tax it is clear that the purchasers bear the tax. For the tax to be borne by the sellers of properties, selling prices would need to drop by the amount of Toronto LTT paid on the transactions. And, of course if prices fall but by less than the tax both sellers and purchasers share in paying the tax.

The literature suggests that sellers in the city of Toronto bear much, if not all, of the LTT with buyers bearing a greater share of the burden in more central and prime locations. The rationale for this is that fringe buyers have a choice of buying in adjacent 905 areas so that sellers in Toronto must make their homes available at prices net of the tax in order to compete.

Any impact of Toronto's LTT on average sale prices of residential properties sold in the city should be discernible by comparing average MLS sale prices in the city of Toronto before and after the tax was imposed with average sale prices in the 905 portion of the Greater Toronto Area where there is not a municipal LTT.

There is no convincing evidence that average MLS sale prices in Toronto and the 905 areas after the LTT came into effect in February 2008 performed differently than before the tax. Figure 1 shows that average prices increased at the same rate over the 2008 – June 2012 period in both areas. This suggests that average prices in Toronto are not affected by the tax. That is, purchasers are bearing the Toronto LTT burden in their closing costs.

This opinion is supported by an identical analysis limited to single-family residences in a band on both sides of the Toronto/905 border (see Figure 1) and a separate analysis of annual MLS average price data (not shown).

It must be noted that this conclusion is based on a time period when there has been a robust housing market in the GTA. It is not obvious that sellers would not bear part of the burden when housing markets turn weaker – something which is inevitable for the GTA market.

Figure 1
Average Prices of MLS Single Family Homes,Toronto and GTA 905 Area, Before and After the Land Transfer Tax

	Toronto	905 Area
Pre-LTT (2005 - 2007)	$488,704	$400,626
Post-LTT (2008 – June 2012)	$608,912	$500,754
Percent Change	24.60%	25.00%

	Band adjacent to the Border of City of Toronto and 905 Area	
	Toronto	**905 Area**
Pre-LTT (2005 - 2007)	$367,802	$413,395
Post-LTT (2008 – June 2012)	$457,168	$524,979
Percent Change	24.30%	26.90%

Source: Benjamin Dachis, *Stuck in Place: The Effect of Land Transfer Taxes on Housing Transactions* , C. D. How e Institute, October, 2012, Table A-1.

Negative Economic Impacts Not a Deciding Factor

Two studies conducted by the C.D. Howe Institute concluded that Toronto's LTT reduced the number of MLS single-family home sales in the city by 16%.[3] Altus Group Economic Consulting examined the negative economic impacts flowing from this 16% reduction in residential transactions and concluded: "Overall, Toronto's MLTT [LTT] 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 loss caused by the new tax."[4]

It is evident that since the LTT came into effect Toronto's share of MLS single-family home sales in the GTA has fallen off. Figure 2 indicates that post-tax MLS sales increased more rapidly in the 905 portion of the GTA than in Toronto.

3. Benjamin Dachas, Gilles Duran ton, and Michael Turner, *Sand in the Gears: Evaluating the Effects of Toronto's Land Transfer Tax*, Commentary No. 277 (Toronto: C.D. Howe Institute, 2008), http://www.cdhowe.org/pdf/commentary_277.pdf and Benjamin Dachas, *Stuck in Place: The Effect of Land Transfer Taxes on Housing Transactions* (Toronto: C. D. Howe Institute, 2012).

4. Altus Group Economic Consulting, *Economic Implications of the Municipal Land Transfer Tax in Toronto*, prepared for the Ontario Real Estate Association (Toronto, Altus Group Economic Consulting, 2014), ii.
http://donttaxmydream.ca/documents/P4925%20OREA%20LTT%20Toronto%20Implications%20Report%20Altus%20Group%20FINAL%5B1%5D.pdf

This finding is supported by an identical analysis limited to single-family residences in a band on both sides of the Toronto/905 border (see Figure 2) and a separate analysis of annual MLS average sales transaction data (not shown here).

Figure 2
Sales of MLS Single Family Homes,Toronto and GTA 905 Area, Before and After the Land Transfer Tax

	Properties	
	City of Toronto	**905 Area**
Pre-LTT (2005 - 2007)	64,278	46,163
Post-LTT (2008 – June 2012)	79,949	67,281
Percent Change	24.40%	45.70%

	Band adjacent to the Border of City of Toronto and 905 Area	
	City of Toronto	**905 Area**
Pre-LTT (2005 - 2007)	13,444	14,329
Post-LTT (2008 – June 2012)	16,575	18,827
Percent Change	23.30%	31.40%

Source: Benjamin Dachis, *Stuck in Place: The Effect of Land Transfer Taxes on Housing Transactions* , C. D. How e Institute, October, 2012, Table A-1.

What is not clear is what caused this shift. The principle conclusion of recent econometric research by Haider and Amar is that any negative impact of Toronto's LTT on sales after the tax was implemented was not statistically significant.[5] That is to say, the relative shift in MLS residential sales from Toronto to the 905 areas after the tax was implemented cannot be automatically attributed to the new LTT – other factors such as the great recession and subsequent recovery and a shift in demand to the 905 area in a quest for more affordable housing could be contributors.

The Altus Group study erred on assuming all of the economic loss it estimates from the lower sales transactions in the city impact only city businesses and none of the economic gains from increased transactions on the 905 side of the Toronto boundary accrue to Toronto businesses. The reality is the economic implications of the shift in home buying estimated in the C.D. Howe Institute studies would be roughly the same after the tax is implemented as before. Buyers in 905 areas adjacent to the City buy goods and services from Toronto businesses and, conversely, homebuyers on the Toronto side buy goods and services from the 905 area. The LTT would not materially affect this underlying pattern of spending by homeowners.

Main Deficiencies: Lack of Equity and Volatile Revenues

A lack of equity/fairness is a key fault of the LTT. In particular, no linkage exists between the payers of the tax and beneficiaries of the municipal spending funded by the tax. That is, the LTT violates the benefits received tax equity principle. Nor is there a direct relationship between the buyers of new and resale homes and their incomes or wealth. The tax also is not in accordance with the ability to pay tax equity principle.

A second flaw of the Toronto LTT is the cyclical nature of its annual revenue stream. When the housing market is robust, like it has been for more than a decade, revenues generated by the tax will be buoyant. In contrast, tax revenues will decline when the next downturn in the market arrives. The dependence of city spending on an unstable tax source like the LTT complicates fiscal budget planning as the spending tap cannot be turned off quickly in response to lower tax revenues.

The Property Tax is a Much Better Tax than the LTT

Economists generally regard the property tax as a good local tax. It is the primary source of funding for Ontario municipalities and produces a great amount of revenue. Its base – the assessed value of real property – is very responsive to real economic growth and inflation as long as assessed values are adjusted regularly to reflect current market values of properties. Currently, properties in Ontario are only reassessed every four years.

The property tax scores much higher than the LTT does in terms of fairness. Many municipal services

5. Murtaza Haider and Anwar Amar, *Did the Land Transfer Tax Affect Housing Sales in the Greater Toronto Area?*, PowerPoint charts for presentation to the Institute on Municipal Finance and Governance, Munk Centre, University of Toronto, November 27, 2014. http://munkschool.utoronto.ca/imfg/uploads/301/ltt_haider_anwar.pdf tend to benefit all property owners and tenants. Therefore, there is a much stronger relationship between taxes paid and benefits received under the property tax than with the LTT which is payable only at the time of property purchase. There is also a closer correlation between ability to pay taxes and property taxes paid than with the LTT.

The property tax is highly transparent. The administrative support system for the property tax is well established and is cost-effective. Replacing the Toronto LTT with property taxes would result in a net cost saving since the property tax administrative costs are already being incurred.

The City of Toronto has Room to Raise Residential Property Taxes

Many Toronto residents and local politicians have the misconception that any increase in the annual tax rate applied by the city on properties represents a tax increase. In a strict sense this is true but it is not meaningful if there has been general inflation or property value increases at the same time.

Comparing the property tax with income and sales taxes, the tax base of these latter taxes – income and consumer spending – automatically increase each year with inflation. Revenues rise each year with inflationary increases in income and spending with no change in tax rates. In this case, both the nominal and real (adjusted for inflation) tax rates are unchanged.

The base of the property tax, in contrast, increases only at the time of reassessment every four years. In the meantime, the real tax rate declines under a constant nominal tax rate when there are inflationary increases in property value. Thus, for example, if the tax rate set by the city increases at the same rate as property values this simply maintains a constant real tax rate. It is not appropriate to regard this higher nominal tax rate as an indicator of a higher real tax rate. It is simply offsetting a rise in property values not reflected in assessed values of residential properties. In actual fact, the real rate of residential property tax has been declining in Toronto for years since the tax rate increases have been less than the rise in property values.

A recent study of Toronto's finances by Slack and Côté found: ". . . . that property tax revenues have grown by less than the rate of inflation since 2000. The average property tax burden per household has actually been *falling*."[6] The study also showed that residential property taxes as a percentage of average household incomes in Toronto is lower than other GTA municipalities like Markham and Mississauga.

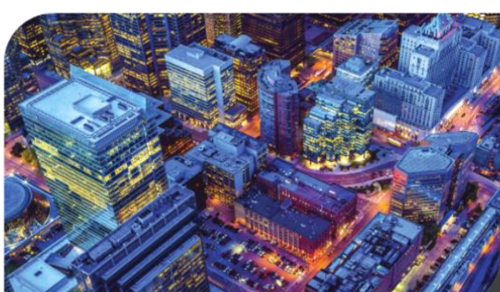
It is evident that Toronto households have room to pay higher residential property taxes.

Recommendations

It is recommended that City Council phase out the LTT over the period of five years starting in 2016 in order to make Toronto's local tax system fairer and tax revenues more stable.

It is also recommended that Ontario reassess properties annually rather than every four years and municipalities in the province be required by legislation to increase annual tax rates by the overall inflation rate measured by the Consumer Price Index (CPI) so that councils focus their attention on increases in real property tax rates only.

6. Enid Slack and André Côté, *Is Toronto Fiscally Healthy? A Check-up on the City's Finances*, IMFG Perspectives No. 7 (Toronto: Institute on Municipal Finance and Governance, Munk Centre, University of Toronto, 2014), 8-9.
http://munkschool.utoronto.ca/imfg/uploads/288/1581fiscallyhealthyr5final.pdf



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