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Dr. Maslove is a professor in the School of Public Policy and Administration at Carleton University in Ottawa, Canada. An economist specializing in public finance, Dr. Maslove is a graduate of the Universities of Manitoba (Canada) and Minnesota (USA). Dr. Maslove is the author or editor of more than 15 books and numerous articles in the areas of public policy, public finance and taxation.

Dr. Maslove served as the **Director of Research for the Ontario Fair Tax Commission (1991-93)**. This Commission was charged with examining and advising the provincial government on all areas of provincial taxation. In addition to its final report (approximately 1100 pages) to the Government of Ontario, the Commission published eight volumes of research studies. Those studies included (among others):

Fairness in Taxation: Exploring the Principles (1993)

Issues in the Taxation of Individuals (1994)

Taxation and the Distribution of Income (1994)

In 2001 Dr. Maslove served as a member of the City of Ottawa's Task Force on Property Assessment and Property Tax Issues.

# TAXING QUESTIONS ABOUT PROPERTY TAXATION



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## TAX FAIRNESS

- What do we mean by “fair”?
  - Ability-to-pay principle
  - Benefit principle

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## FAIRNESS: Ability-to-Pay

- Differing capacities → Differing tax levels
- Similar capacities → Similar tax levels

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## FAIRNESS: Benefit

- Relating to benefits from public services
- Benefits of some municipal services are clearly linked to properties - water & sewer, roads, (some of) police protection
- Others are not - recreation, transit, (some of) police protection, & education

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## Big Question

- Do property taxes on rental residential properties meet either test of fairness, particularly when compared to owner-occupied residences?
- We need to examine 2 elements in determination of tax loads - assessment and rates

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## ASSESSMENT

- Based on the concept of market value (MVA) – almost universal in North American jurisdictions.
- Defined differently but consistently across provinces....

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## MVA Definitions

- New Brunswick – “... real and true value...”
- Nova Scotia – “... market value is the most probable price that an unencumbered property would sell for on the open market...”
- PEI – “... the most probable sale price...”

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## MVA Definitions

- Ontario – “...in relation to land, the amount of money the fee simple, if unencumbered, would realize sold at arm’s length by a willing seller to a willing buyer...”
- Saskatchewan – “... fair value ...”
- Alberta – “... the most probable price that a property would sell for on a given date...”
- B.C. – “... price an unencumbered property would sell for on July 1 of the preceding year if a reasonable amount of time is allowed to find a purchaser...”

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## Is MVA Fair?

- Methodologies may differ but all jurisdictions assess residential (R) and rental apartment (APT) properties at full value
  - Recognizing issues arise in implementation
- MVA vs. Ability-to-pay
- MVA vs. Benefit Principle

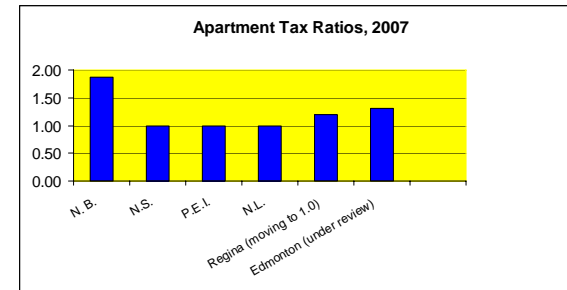
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## Tax Rates

- This is where things get interesting!
- Effective (rate on APT/rate on R):
  - New Brunswick – 1.89
  - Nova Scotia - 1.00
  - P.E.I. - 1.00
  - Newfoundland/Lab. 1.00
  - Regina - 1.20 (moving to equal rates over 5 years beginning in 2006)
  - Edmonton - 1.30 (under review)

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## Apartment Tax Ratios



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## The Higher Tax on Rentals

- Assuming that all residential properties are correctly assessed at MVA, the rate differentials mean that rentals are taxed more heavily than owner-occupied
- So who pays? What is the incidence?

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## Tax Incidence Analysis

- Who pays the baseline property tax when the dust settles?
- Property tax is partly on land and partly on structures
  - Land portion – not shifted, borne by owner (capitalized)
  - Structure portion – shifted to tenants (higher rents)

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## Incidence (cont'd)

- The differential tax on rentals is effectively on structures only
- Therefore the differential is fully borne by tenants
- Effect is to tax tenants more heavily than owner-occupiers.

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## The Fairness Tests

- Ability-to-pay – Mean incomes of families (2000) in:

|        | Owner-occ.<br><u>residences</u> | Rented<br><u>residences</u> |
|--------|---------------------------------|-----------------------------|
| N.B.   | \$53,700                        | \$29,200                    |
| N.S.   | 56,100                          | 30,200                      |
| Canada | 70,300                          | 36,000                      |

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## The Fairness Tests

- Benefit – No reason to think benefits flowing to rental properties are greater than those accruing to owner-occupied
  - In fact, rentals may be less costly to service because of higher density
- Therefore both tests failed!

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## So Why Does This Happen?

- Do governments not understand?
  - But there is lots of evidence to say they do understand
    - A long history of studies
    - Several provinces have never taxed rentals at higher rates (B.C., Que., N.S., N.L., P.E.I.)
    - Several provinces did tax rentals at higher rates but are moving/have moved to parity (Alta., Sask., Man., Ont.)
    - N.B. stands alone!!

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## Another Possibility

- A political hypothesis
  - Property tax is a zero-sum game
  - 3 broad sources – rentals, owner-occupied, commercial/industrial
  - Area of common cause between landlords and tenants and the recent N.B. Finance Discussion Paper creates an opportunity for reform

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## What if rates were equalized?

Impact of rate equalization



The average tenant would save \$50 per month!

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## What if rates were equalized?

- Example – Average rent in N.B. of \$600 for an average APT assessed at \$40,000. Property tax (@3%) is \$1200 per year.
- If differential removed, tax falls to \$600 per year. Pass through of saving to tenants could lower rents by as much as **\$50 per month**.

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