

*Big City Tax Tools:
A Comparison of Taxation in Western Canadian
and Northwest American Cities*

*Address to the Institute on Municipal Finance and Governance,
Casey G. Vander Ploeg, Senior Policy Analyst, Canada West Foundation,
Munk Centre for International Studies, Toronto, Ontario, February 21, 2005.*

CANADA WEST FOUNDATION: A Description

A Public Policy RESEARCH Institute

- Independent
- Non-Partisan
- Non-Profit

PURPOSE of Canada West Foundation

- Introduce Western Perspectives Into Policy Debates
- Produce and Disseminate Objective Policy Research
- Act as a Catalyst for Informed Public Debate
- Create Initiatives for Citizen Engagement

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WESTERN CITIES PROJECT: Canada West Research Reports on Urban Finance

- Financing Western Cities (Introduction to Fiscal Issues)
- Dollars and Sense (Review of the Fiscal Health of Cities)
- Framing a Fiscal Fix-Up (Options to Strengthen City Finances)
- Whistler and the World (Funding of Ski Resort Communities)
- Big City Revenues (Comparison of Canada-US Municipal Taxes)
- A Capital Question (State of Urban Infrastructure)
- No Time To Be Timid (Options for Financing Urban Infrastructure)
- Big Spenders (Expenditure analysis of western big cities)
- Straight Talk (Property taxation in western Canada)
- Foundations for Prosperity (Municipal Infrastructure Debt in Alberta)

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WHY THE FOCUS ON CITIES?

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GLOCALISM:

The Global Economy and the Importance of Local Space

- The rise of the information or knowledge-based economy, combined with increasing global competition, makes local conditions more important. This has been termed GLOCALISM.
- In other words, quality of life in our cities is critical to attract and retain the skilled human capital to compete and succeed in this new economy.
- Knowledge industries, and their workers, are FOOTLOOSE. Through technology, they can locate almost anywhere in the world to do almost anything.
- This implies a need for WELL-FINANCED cities that effectively and efficiently deliver a high quality package of municipal services and infrastructure.

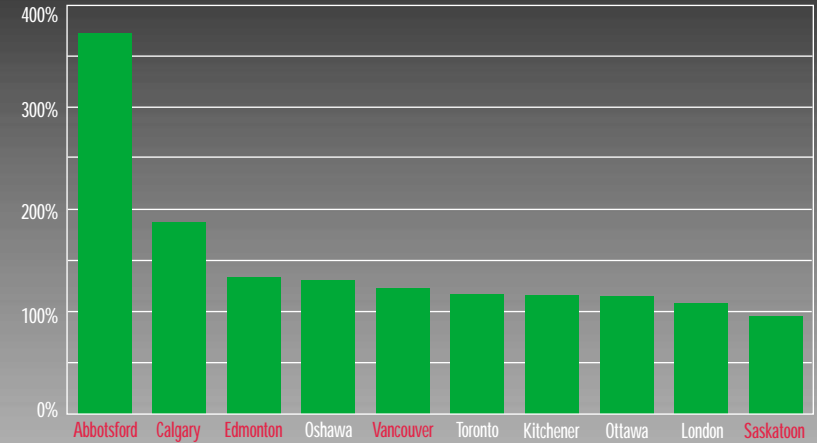
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MUNICIPAL FISCAL STRESS: A Difficult Decade

- Real per capita municipal spending on PROGRAMS has not risen appreciably between 1990-2003 for most large cities in the West.
(Dollars and Sense and Big Spenders)
- Real per capita municipal spending on CAPITAL either fell or remained generally flat during most of the 1990s. Capital spending is only now starting to increase.
(A Capital Question)
- Tax revenue growth for large western cities has been SLUGGISH. Operating and capital grants have also fallen. These have not always been offset by increased user fees.
(Straight Talk)
- Cities are avoiding the DEBT financing of tax-supported capital needs.
(Dollars and Sense, No Time to be Timid)

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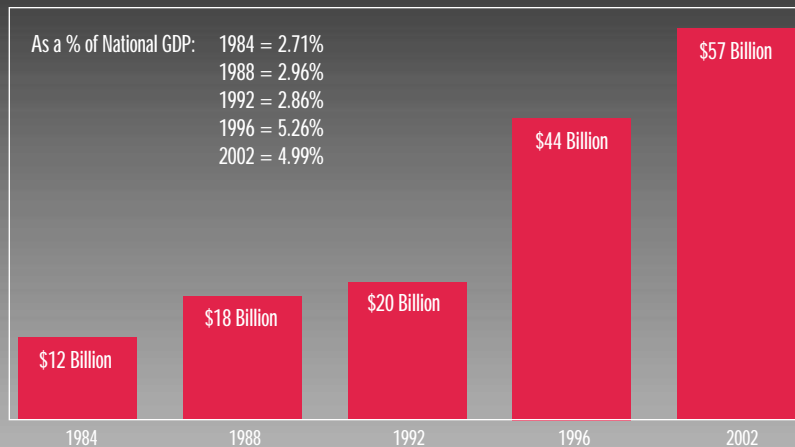
TEN FASTEST GROWING CMAs IN CANADA: 1966-2001



SOURCE: Derived by Canada West Foundation from the 1966 and 2001 Census.

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MUNICIPAL INFRASTRUCTURE DEBT ESTIMATES Commonly Cited Estimates in Billions of Nominal \$



SOURCE: "A Capital Question" (Canada West Foundation, 2003)

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INFRASTRUCTURE IN EDMONTON AND CALGARY: Reported Short-Fall in Infrastructure Funding Going Forward

Edmonton:

- \$126.5 million infrastructure deficit reported for 2003.
- \$1.551 billion infrastructure deficit for 2003-2007.
- \$3.200 billion infrastructure deficit for 2003-2013.

Calgary:

- \$136.1 million infrastructure deficit reported for 2003.
- \$1.120 billion infrastructure deficit for 2003-2007.

The unfunded infrastructure is split almost equally between amounts needed to rehabilitate EXISTING assets and build NEW infrastructure additions. These amounts are conservative, but are GROWING.

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MUNICIPAL INFRASTRUCTURE DEFICITS AND DEBT: The Essential Conclusion

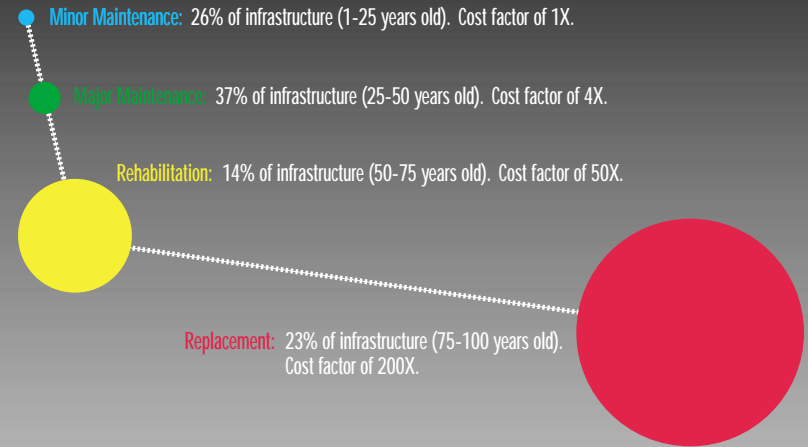
The EXACT parameters of the municipal infrastructure debt in Canada and Alberta are open to debate.

HOWEVER:

- There is a BROAD consensus that this debt exists.
- There is a BROAD consensus that this debt is substantial.
- There is a BROAD consensus that this debt threatens quality of life.
- There is a BROAD consensus that this debt threatens economic prosperity and limits the potential of our national, regional, provincial, and local economies.

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THE SITUATION IN HAMILTON, ONTARIO: Water and Sewer Infrastructure Profile



SOURCE: "A Capital Question" (Canada West Foundation, 2003)

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WHAT ARE THE POLICY OPTIONS TO ADDRESS THE CHALLENGES?

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NO TIME TO BE TIMID: Five Options for Systemic Urban Finance Reform

- Keep the focus on CORE responsibilities and priorities. Get back to the primary purposes of municipal government, or have existing responsibilities better squared with current fiscal resources.
- Set CORRECT prices for municipal services and expand user fees. User fees are not simply a means to generate revenue. They act as price signals, limiting demand for infrastructure and services.
- Adopt a COMPETITIVE model for municipal service delivery (ASD). Monopoly service provision is inefficient and wastes scarce resources.
- Vigorously pursue NEW and INNOVATIVE sources of capital financing, especially participation from the private sector (PPPs).
- Secure new TAX TOOLS or TAX-SHARING with other governments.

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SOME TAX COMPARISONS

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THE CITIES OF EDMONTON AND CALGARY: Tax Tools and Revenue Sources

Local Taxes in Play:

- Property Tax
- Business Tax (Property-based)
- Franchise and Utility Taxes

Tax-Sharing:

- Provincial Fuel Tax

Other Revenues:

- Federal Grants
- Provincial Grants
- User Fees
- Investment Income
- Licenses, Permits, Fines

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THE CITY OF DENVER, COLORADO

Local Taxes in Play:

- Property Tax
- General Retail Sales Tax
- Sales Tax on Lodging
- Sales Tax on Restaurants/Liquor
- Sales Tax on Off-sales of Liquor
- Sales Tax on Vehicle Rentals
- Sales Tax on Aviation Fuel
- Sales Tax on Entertainment Events
- Employee Head Tax
- Franchise and Utility Taxes
- Auto Ownership Tax

Other Taxes Available:

- Real Estate Transfer Tax
- Most taxes except Income Taxes

Tax-Sharing:

- State Fuel Tax
- State Tobacco Tax
- State Vehicle Registration Tax
- State Lottery Revenue Tax

Other Revenues:

- Federal Grants
- State Grants
- User Fees
- Investment Interest
- Licenses, Permits, and Fines

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THE CITY OF SEATTLE, WASHINGTON

Local Taxes in Play:

- General Retail Sales Tax
- Sales Tax on Entertainment
- Sales Tax on Gambling
- Sales Tax on Restaurants
- Sales Tax on Bars and Pubs
- Sales Tax on Vehicle Rentals
- Gross Receipts Tax
- Franchise and Utility Taxes
- Motor Vehicle Excise Tax
- Real Estate Excise Tax

Other Taxes Available:

- Employee Head Tax
- Square Footage Business Tax
- Head Tax or Poll Tax

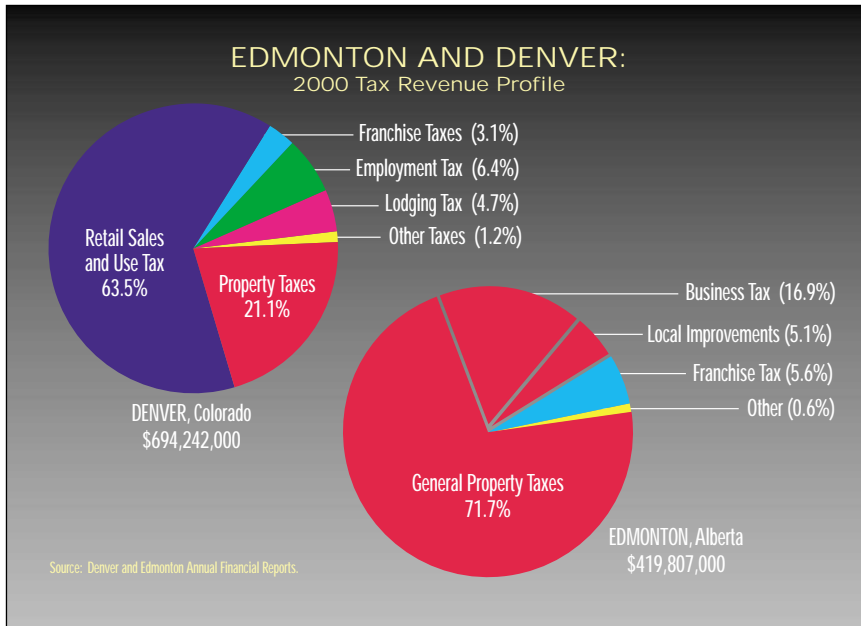
Tax-Sharing:

- State Liquor Tax
- State Fuel Tax
- State Lodging Tax
- State Insurance Premium Tax
- State General Retail Sales Tax
- State Leasehold Excise Tax
- State Hazardous Waste Tax
- State Utility Tax
- State Timber Tax
- State Solid Waste Tax

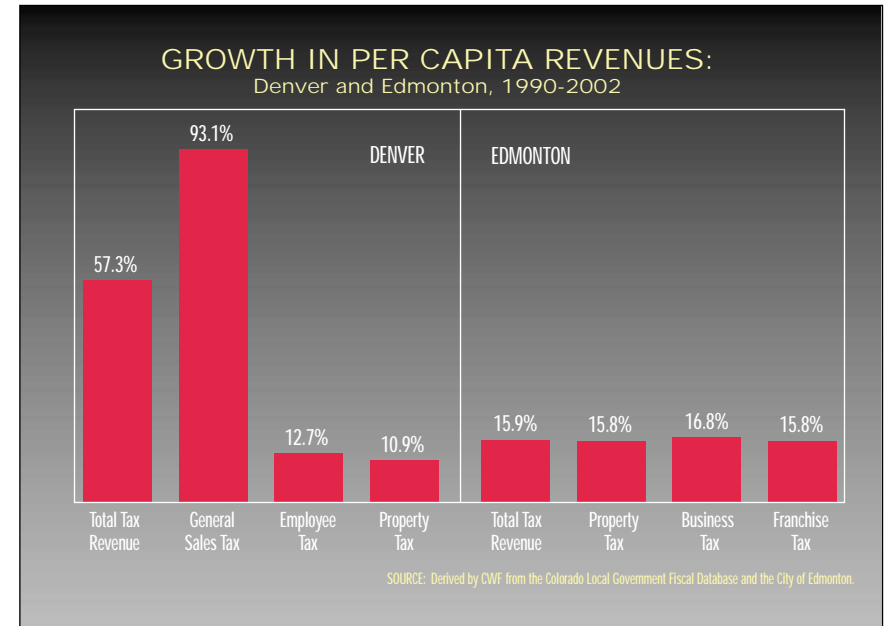
Other Revenues:

- Federal and State Grants
- User Fees
- Interest, Licenses, Permits, Fines

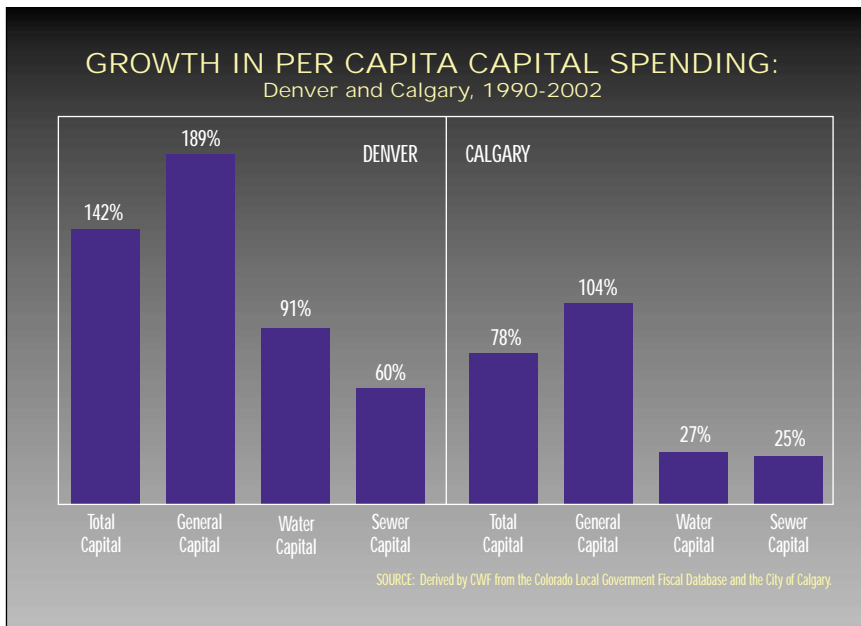
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WHY NEW TAX TOOLS?

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WHY NEW TAX TOOLS: Lack of Diversity and Limited Revenue Generation

There are TWO fundamental problems with the revenue sources currently open to cities:

- Current revenue sources lack DIVERSITY. There are only three main sources of revenue, including property taxes, grants, and user fees.
- The revenue-generating capacity of these sources are LIMITED. Steadily increasing levels of revenue that grow alongside population increases and economic growth are outside of the control of municipal governments or simply not possible without deliberate tax rate increases.

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WHY NEW TAX TOOLS: The Difficulty of Employing the Property Tax

- Because the property tax base is narrow, cities often have to adjust the property tax rate just to compensate for inflation and increased costs. In the media, this is often called a tax INCREASE.
- Federal and provincial governments, however, have a more diverse tax system, one that AUTOMATICALLY responds to inflationary pressures, increases in incomes, and expansion of the economy.
- The property tax places cities at a political disadvantage. To ensure adequate revenue growth, cities are accused of increasing taxes, when relative to income, property taxes may have stayed the same, or even FALLEN.

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INELASTICITY: A Property Tax Example

- For the 2002 Budget, a 3.0% property tax "increase" was proposed by administration to Calgary City Council...
- For the owner of a \$165,000 home (median value of a home in Calgary in 2001) this meant an additional \$21.00 for the taxpayer in 2002, or about \$1.75 per month...
- The additional money sought by the City of Calgary required a deliberate and intentional adjustment of the property tax rate...

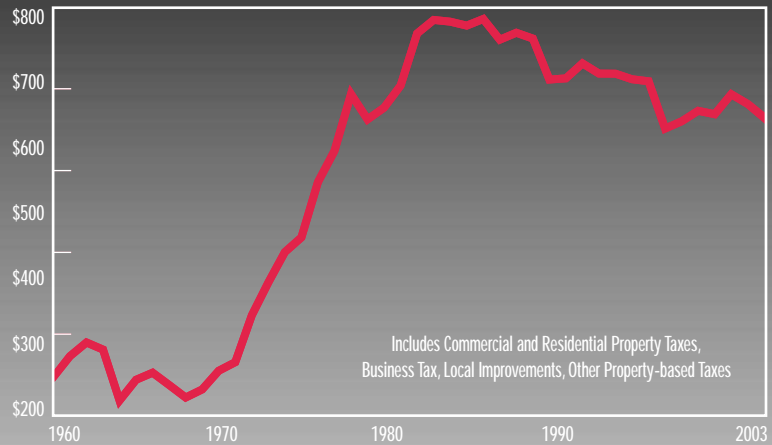
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ELASTICITY: Personal Income and Sales Taxes

- Assume a Calgarian earning \$60,000 per year in 2001 received a 3% pay increase of \$1,800 for 2002...
- The personal income tax payable for that extra income in 2002 over 2001 would be \$399.62...
- If that Calgarian also spent half of the pay raise (\$900), sales tax revenue to the federal government would be \$63.00...
- Federal and provincial governments collect an additional \$462.62 with NO increase in the tax rate.

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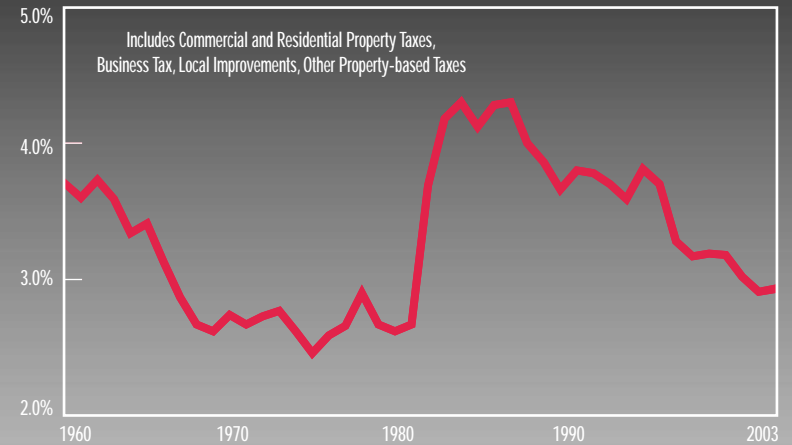
PROPERTY TAX COLLECTIONS IN EDMONTON: Real Per Capita Property Taxes Collected



SOURCE: Derived by Canada West Foundation from cities' Annual Reports, DBRS, Revenue Canada.

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PROPERTY TAX COLLECTIONS IN EDMONTON: Taxes Collected as a Percent of Personal Disposable Incomes



SOURCE: Derived by Canada West Foundation from cities' Annual Reports, DBRS, Revenue Canada.

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NEW TAX TOOLS: Progress in the West

PROGRESS IN THE WEST

Developments with New Tax Tools and Revenue-Sharing

- BRITISH COLUMBIA: The Regional Transit Authority in the Vancouver city-region receives some provincial fuel tax.
- ALBERTA: Both Calgary and Edmonton now receive 5¢ of the 9¢ provincial sales tax on fuel sold within their borders. Dollars are used for transportation and other infrastructure investments.
- SASKATCHEWAN: The twin cities of Saskatoon and Regina led a drive to replace some property tax with provincial fuel tax at a recent SUMA annual convention – the resolution failed.
- MANITOBA: Winnipeg already enjoys tax-sharing with the province (e.g., provincial personal and corporate income taxes). But, Winnipeg also put forward a bold plan for a "New Deal" that would see property taxes slashed and different taxes and fees implemented.

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WINNIPEG'S "NEW DEAL" PROPOSAL

- REDUCE and/or ELIMINATE:**
- Eliminate the property-based business tax.
 - Eliminate water and sewer frontage levies.
 - Eliminate all provincial grants.
 - Eliminate the local amusement sales tax.
 - Reduce general residential property taxes by half.
 - Lower the general commercial property tax.
- IMPLEMENT and/or INCREASE:**
- Implement a small local general retail sales tax.
 - Implement a local fuel sales tax.
 - Implement a local liquor tax.
 - Implement a local lodging tax.
 - Implement a road frontage levy.
 - Increase electrical and natural gas sales tax.
 - Increase provincial tax revenue-sharing.
 - Increase certain user fees.

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NEW TAX TOOLS: Implementation

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IMPLEMENTING NEW TAX TOOLS

- Cities would benefit from a more DIVERSE set of tax tools.
- A fundamental shift in taxes from the federal and provincial governments to cities is likely NOT on the table. The competition for scarce tax dollars is fierce. Ottawa is hesitating, and in 2003, all provinces except Alberta ran deficits.
- This tax shift could be construed as a tax "increase." That may result, but not necessarily. The tax shift may simply RESTORE municipal tax revenues to historical levels, which were higher than they are now.
- Local tax reform is helped when the change is revenue neutral. Tax reform stands an even better chance when the tax BURDEN is lowered at the same time that the tax STRUCTURE is changed.
- Because provincial agreement is required, cities must ensure that any new tax regime is a "WIN-WIN" for the province, the taxpayers, and the cities themselves.

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A PROPOSAL FOR CHANGE

- Cities could first agree to ELIMINATE the business tax and implement a SIGNIFICANT one-time reduction in property taxes.
- Negotiations with the province could commence on replacing the lost property tax revenue with a NEW combination of taxes or tax-sharing that offer better revenue-generating capacity.
- In the short-term, this tax shift could act as a TAX CUT, making the change more appealing to citizens and the province.
- Replacing some pay-as-you-go capital financing with debt financing could bridge the revenue shortfall over the short-term. The new tax tools, which are more elastic, will eventually CATCH UP and set cities on a more robust and dynamic revenue trajectory.

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THE CHALLENGE OF CHANGE

- Change of this magnitude is NOT easy. The change involves money, and money implies a shift in political power. Power is not generally ceded voluntarily.
- Thus, a sustained effort must be put forth, and CITIES themselves must lead the effort. No one can lead it for the cities.
- Further, the public needs to be engaged and must also begin to agitate for the change. In order for this to happen, it is essential that a COALITION of interests emerge to begin pushing for change.
- Developing such a coalition may seem laughable at first, but there are a wide diversity of interests that could aggregate on the issue of local tax reform...

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A COALITION FOR CHANGE

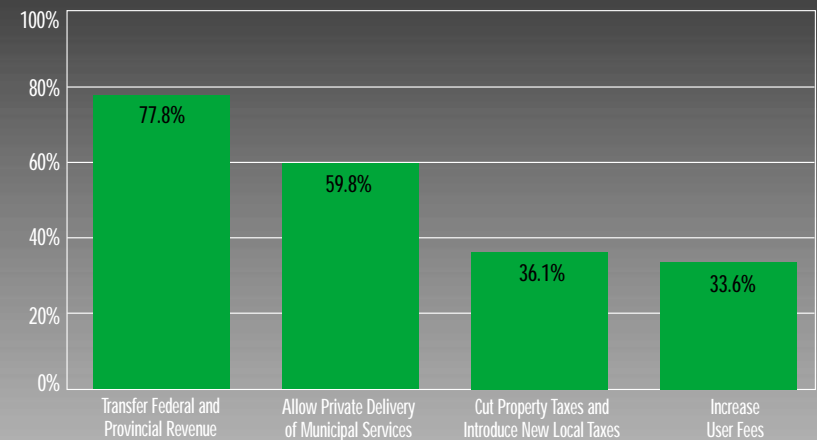
- **LOW-INCOME INDIVIDUALS:** Those with low incomes pay relatively higher effective rates of property taxation on one of the most basic needs – shelter. Lower income individuals and their advocates would support change once they understand property taxes are more regressive than a sales tax that can be avoided and would exempt basic needs.
- **BUSINESS:** Business and their lobby would support eliminating a business tax that is unrelated to profit and thus is a fixed input cost. They too carry a disproportionately higher property tax burden. A new set of tax tools could allow taxes to be more easily shifted to the consumer.
- **ENVIRONMENTALISTS:** Because a new tax regime could help mitigate against sprawl, this interest can also be brought on board.
- **TAXPAYER GROUPS:** Such groups are beginning to emerge as advocates of local tax reform, and would clearly support a tax cut.

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NEW TAX TOOLS: Public Opinion

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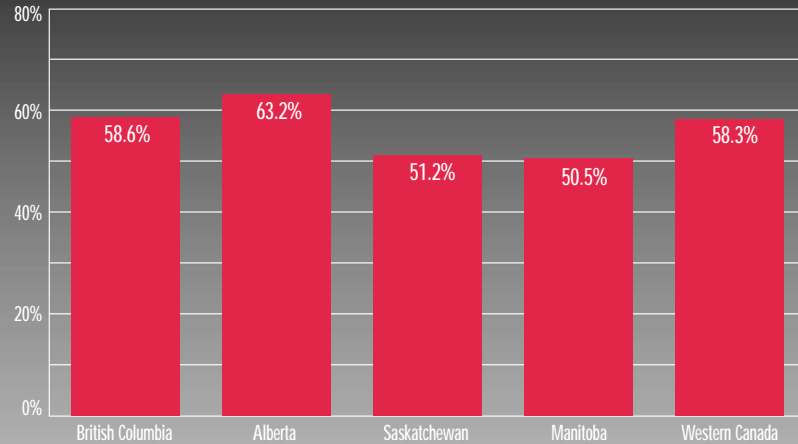
CWF LOOKING WEST SURVEY 2003: Western Public Opinion on Tax Shifting



SOURCE: Canada West Foundation Looking West Survey 2003.

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CWF LOOKING WEST SURVEY 2003: Western Public Opinion Against Tax Shifting



SOURCE: Canada West Foundation Looking West Survey, 2003.

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NEW TAX TOOLS: Some Cautions and a Question

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CAUTIONS ON U.S. STYLE LOCAL TAXES

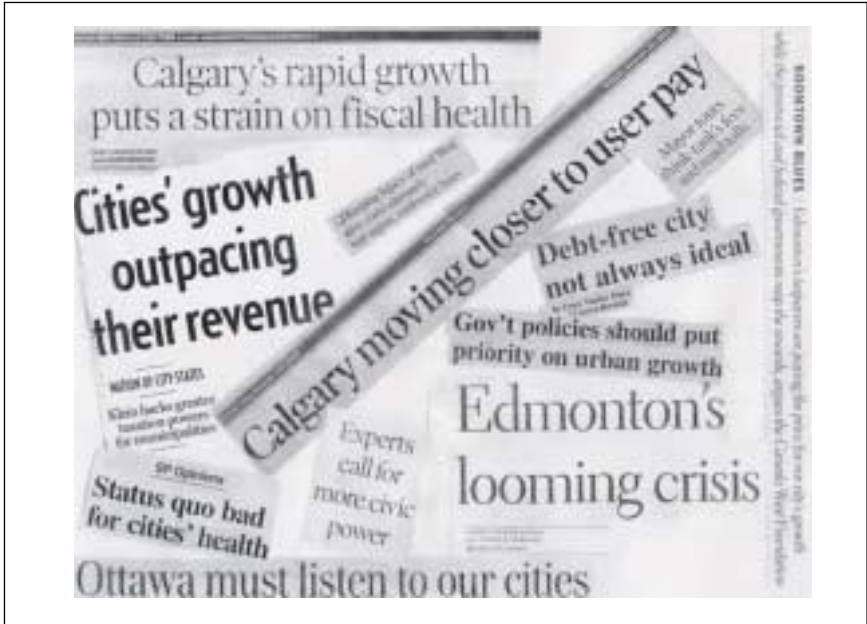
- Sales taxes are collected and administered by state governments. Revenues are returned to cities.
- These amounts are NOT always returned based on point of sale. Revenues are sometimes equalized for cities with a smaller sales tax base.
- Revenues are often EARMARKED for specific purposes.
- Sales tax rates are usually specified or CAPPED and increases are often subject to voter approval. Property tax revenues are often capped.
- U.S. cities are NOT necessarily collecting more revenue as a result of a more diverse tax system. They simply collect the money differently.
- Sales taxes are more elastic, so revenues can stall or decline due to economic recession. As such, the property tax remains the foundation tax for most U.S. cities. Sales taxes are usually SUPPLEMENTAL.

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A FUNDAMENTAL CHOICE TO MAKE:

- Is it better for a city to be overly reliant on property taxes, BUT at the same time free from restrictions on the tax rate, the revenue generated, and the use of the revenues?
- OR, is it more desirable to have access to a small local general sales tax, as well as other taxes, that address fiscal disequivalence, provide better revenue-generating capacity in the good times, but where the tax rates are capped, revenues are earmarked, and any slowdown in the economy threatens the tax base?
- The FIRST scenario provides for a higher level of autonomy and more stable revenue flows. But, it provides no relief from fiscal disequivalence and does not allow cities to capture a wider range of economic activity occurring in their boundaries. The SECOND scenario addresses these concerns, but at the expense of municipal autonomy and flexibility. There is a TRADE-OFF here to manage.

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