TORONTO

STAFF REPORT
ACTION REQUIRED

Municipal Land Transfer Tax Reduction Options

Date:	June 18, 2013
To:	Executive Committee
From:	City Manager Deputy City Manager and Chief Financial Officer
Wards:	All
Reference Number:	P:\2013\Internal Services\Cf\Ec13011cf (AFS #17433)

SUMMARY

This report responds to a request from Executive Committee to report to the July 3, 2013 Executive Committee on potential options for capping, reducing (by 10%) or eliminating the City's Municipal Land Transfer Tax (MLTT) over four years, through reductions to applicable tax rates and increases to the first-time home buyer rebate.

Potential revenue impacts would depend on how much the rates in each tier of the MLTT tax structure are reduced, and whether the first time home purchasers rebate is amended. Based on the 2012 net MLTT revenue of $344.5 million, a 10% reduction of the MLTT is equal to $34.5 million (or 1.5% of residential property tax impact). A 25% reduction is equal to $86.1 million (or 3.6% residential property tax impact).

The MLTT has become a key sustainable own-source City revenue since its 2008 inception, generating almost 10% of the net tax-supported operating budget. Although the City is approaching fiscal sustainability, the current 2014 operating budget outlook requires an efficiency savings target of $197 million to $203 million, after an assumed 1.75% to 2% property tax increase and other user fee increases. Any reductions in the MLTT revenue would increase operating budget funding pressures and resulting expenditure program impacts for 2014 and beyond.

Staff are hesitant to amend MLTT tax rates before any consideration of the potential expenditure and program impacts. As a result, it is recommended that this report be forwarded to Budget Committee for consideration of the 2014 budget.

RECOMMENDATIONS

The City Manager and the Deputy City Manager and Chief Financial Officer recommend that:

1. This report be referred to the Budget Committee to be dealt with as part of the 2014 budget process.

Financial Impact

There is no financial impact resulting from this report. However, if Council elects to amend the MLTT by-law, or even signal its intent to make specific by-law changes in the future, in-year real estate market reaction (i.e real estate sales) and MLTT revenue changes could result. Changes to the MLTT rates and or rebate structure could be considered as part of the City's annual budget process.

DECISION HISTORY

On October 22 - 23, 2007 City Council approved the MLTT under the authorities provided in the *City of Toronto Act, 2006*. The following link contains Council decision regarding the staff report EX10.1 titled "New Taxation Measures City of Toronto Act, 2006"
http://www.toronto.ca/legdocs/mmis/2007/cc/decisions/2007-10-22-cc13-dd.pdf

On November 19 - 20, 2007 Council approved the MLTT administrative design features and authorities for implementation effective February 1, 2008. The following link contains Council decision regarding the staff report EX13.7 titled "New Taxation Measures – Design Features and Implementation Authorities":
http://www.toronto.ca/legdocs/mmis/2007/cc/decisions/2007-11-19-cc14-dd.pdf

On February 20 and 21, 2013, City Council referred Motion MM30.16 Capping the Municipal Land Transfer Tax to the Executive Committee.

On March 20, 2013 the Executive Committee referred item EX29.12 to the Deputy City Manager and Chief Financial Officer with the request to report to the July 3. 2013 Executive Committee meeting on the following:

1. Potential options for, and the related implications of, implementing a cap on municipal land transfer tax revenue for 2014 and beyond.
2. Increasing the level of rebates of Municipal Land Transfer Tax for first-time homebuyers.
3. Ways to end the Land Transfer Tax by reducing it by 25% per year over 4 years.
4. Reducing the Land Transfer Tax by 10%.

The following link contains the committee decision:
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2013.EX29.12

ISSUE BACKGROUND

The City of Toronto is the only Ontario municipality currently permitted to levy a municipal land transfer tax under the authorities provided to it by the *City of Toronto Act, 2006*. City Council implemented the MLTT effective February 1, 2008. It is collected by Teranet Inc. under a services agreement with the City. Teranet also collects Provincial Land Transfer Tax ("LTT"), and operates the Provincial electronic land titles registry system. Land transfer taxes are collected at the time of land title transfer ("closing"), and remitted net-after-fees to the City on a daily basis. A small amount of MLTT is collected over the counter by the City (on manually registered property transfers).

Rates

The City's tiered MLTT tax rate structure is similar to the Provincial LTT structure, although some City rates are lower. The total MLTT tax is a blend of the tiered rates. The rates are progressive: a higher marginal rate is generally applied to the higher portions of a transaction price. For example, on a $500,000 residential property sale the marginal tax rate (on the value over $400,000) is 2%, but the total blended tax works out to 1.145%. Table 1 summarizes MLTT rate structure, compared with that of the Province's LTT:

Table 1 — Land Transfer Tax rate structure

<table>
<tr><th rowspan="2">Value of Consideration</th><th colspan="3">Residential *</th><th colspan="3">Non-residential</th></tr>
<tr><th>City of Toronto</th><th>Province of Ontario</th><th>Total</th><th>City of Toronto</th><th>Province of Ontario</th><th>Total</th></tr>
<tr><td>$0-$55,000.00</td><td>0.5%</td><td>0.5%</td><td>1.0%</td><td>0.5%</td><td>0.5%</td><td>1.0%</td></tr>
<tr><td>$55,000.01 - $250,000.00</td><td>1.0%</td><td>1.0%</td><td>2.0%</td><td>1.0%</td><td>1.0%</td><td>2.0%</td></tr>
<tr><td>$250,000.01 - $400,000.00</td><td>1.0%</td><td>1.5%</td><td>2.5%</td><td>1.0%</td><td>1.5%</td><td>2.5%</td></tr>
<tr><td>>$400,000.00</td><td rowspan="2">2.0%</td><td rowspan="2">2.0%</td><td rowspan="2">4.0%</td><td>1.5%</td><td>1.5%</td><td>3.0%</td></tr>
<tr><td>>$40 million</td><td>1.0%</td><td>1.5%</td><td>2.5%</td></tr>
</table>

* Residential = property which contains at least one, and not more than two, single family residences

Revenues

The City's 2012 net MLTT revenue was $344.5 million. The 2013 Council approved net MLTT revenue budget is $315.0 million. Table 2 below summarizes the budgeted and actual net MLTT revenues since its inception.

Table 2 — Net MLTT revenues since 2008

Net Revenue ($ Million)

		2008	2009	2010	2011	2012	2013	2013 Q1
Budget		155.0	160.0	170.0	220.0	288.0	315.0	60.5
Actual		154.9	178.5	274.5	319.2	344.5	Na	60.9
Budget Variance	Amount	-0.1	18.5	104.5	99.2	56.5	Na	0.4
	%	0%	11%	61%	45%	20%	Na	1%

*As of May 31, 2013, the MLTT surplus is $11 million.

Rebates

Both the Provincial and City regimes incorporate an automatic rebate at the time of payment for buyers who identify themselves as first-time home buyers (FTHB) i.e. having never previously owned a home at any location. The maximum provincial rebate is $2,000 (corresponding to the LTT on a $227,500 home), and the maximum City rebate is $3,725 (corresponding to the MLTT on a $400,000 home).

When the MLTT was first introduced in 2008, it was estimated the first-time home purchasers rebate would be about $40 million per year and comprise about a third of the residential market. Since then the value of the rebates has increased with increases in sales volumes and market prices to between $54 and $62 million. The rebate as a percentage of the tax collected (residential only) was at its highest at 42% in 2009 but has since decreased to 25% in 2012. Table 3 below summarizes the annual rebates since inception:

Table 3 — FTHB rebate since 2008

Rebate for First-time Home Purchasers	2007 Estimates	Actual Amounts				
	2008	2008	2009	2010	2011	2012
Annual rebate amount	$40.0M	$37.1M	$54.4M	$58.5M	$61.6M	$54.5M
Rebate as a % of residential MLTT collected	33%	28%	42%	35%	31%	25%

COMMENTS

The MLTT was designed to operate on the same system as the Provincial tax, and use the same rules, exemptions, and tiered rate structure. Since its inception, the MLTT has operated well, with administrative costs below 2%.

The tax is paid by the buyer in a real estate transaction. The tax would in most circumstances marginally reduce prices that might otherwise be paid, and it certainly increases transaction costs, so the MLTT would be expected to have a slight cooling effect on the real estate market. For these reasons, advocacy groups, including C.D. Howe, Canadian Taxpayers Foundation and the Toronto Real Estate Board, have opposed the MLTT or lobbied for its elimination or reduction.

However, market prices and volumes in Toronto have risen considerably since the tax was introduced in February of 2008, and compared favourably with neighbouring jurisdictions that do not have the MLTT. The City's MLTT revenue has grown by over 20% a year on average, becoming an important own-source revenue for the City, and generating almost 10% of the net tax-supported operating budget. The growth in MLTT revenue has helped allow property tax increases to stay low, and has supported key fiscal strategies such as mitigating debt issuance through contributions to budget surpluses dedicated to capital.

The following discussion is based on electronic 2012 actual MLTT data, excluding manual (over the counter) transactions which represented about 1.6% of total MLTT revenue or 0.4% of total transactions.

Potential MLTT Rate Amendments

Unlike provincial processes, Council policy reviews and decisions are made in public, generally over a lengthy period of time. Changes to MLTT rates debated and determined well in advance of implementation could have a notable effect on the real estate market. For example, in anticipation of the introduction of the HST in Ontario, many home buyers advanced their purchase transactions to before the July 1, 2010 implementation in order to avoid the tax, resulting in record real estate sales and resulting MLTT revenues in the preceding month.

Announcement of a pending tax rate decrease could delay purchase decisions and transaction closings until after the implementation date, resulting in delays of hundreds of millions of transactions and related tax revenue, to the detriment of market participants and City revenues. Therefore, any future decisions for a significant policy change should be made effective promptly, subject to required system implementation time, to avoid potential market distortion and revenue impacts.

Rebate for First-time Home Purchasers

The City's first-time home purchasers (FTHB) rebate can apply to any residential property transaction. Table 4 shows that in 2012, 61% of the transactions where the purchaser identified himself as a first-time home purchaser related to prices below $400,000. Virtually all residential transactions under $400,000 obtained the rebate.

Table 4 — First-time home purchasers: 2012 data (Residential only)

Value of consideration	FTHB Transaction volume		Value of FTHB Rebate
	Count	% of total	
$0-$55,000.00	54	0%	-
$55,000.01 - $250,000.00	3,255	17%	$5.3 M
$250,000.01 - $400,000.00	8,109	44%	$23.8 M
>$400,000.00	7,223	39%	$25.4 M
Total	**18,641**	**100%**	**$54.5 M**

The first-time home buyer rebate is designed to promote home ownership in the interest of social equity and stability, by making ownership more affordable for those who have never owned a property. In order to qualify for the rebate, the purchaser must attest that they have never owned a home or had any ownership interest in a home, anywhere in the world. If the purchaser has a spouse, the purchaser's spouse cannot have owned a home or had any ownership interest in a home, anywhere in the world while he or she was the purchaser's spouse.

Compliance

The Province regularly conducts compliance audits on the land registry system. After years of negotiation the City has only recently (in 2013) executed an agreement with the Province of Ontario to share administrative information including audit and compliance activities and results. This cooperative agreement will soon result in the first insights into the rate of non-compliance or false reporting of first-time home buyer status in Toronto, and the effectiveness and appropriateness of the City's current rebate levels.

City staff will review the Province's audit and compliance activities and results and report back through the 2014 budget process on implications for the effectiveness and appropriateness of the City's current rebate levels. It would be premature to consider an increase in the rebate amount prior to considering that report.

Potential First-Time Home Purchasers changes

Table 5 below summarizes the impacts of potential changes to the first-time home purchasers rebate as requested by the Executive Committee, followed by a discussion of each of the cases:

Table 5 – Summary of potential changes for first-time home purchasers rebate

		Impact on FTHB rebate per transaction	Estimated tax revenue impact — Increase (Decrease)
A.	Increasing FTHB rebate threshold from $400,000 to $475.000	($1,500)	($9.0 M)
B.	Harmonizing City's rebate with Provincial rebate	+$1,725	+$18.6 M
C.	Eliminating City's FTHB rebate	+$3,725	+$54.5 M

based on 2012 MLTT data

A. Increasing the FTHB rebate from $400,000 to $475,000

The City MLTT on the first $400,000 transaction price is $3,725. For a home worth $475,000, the total tax payable is $5,225, an additional $1,500 (at the marginal rate of 2%). For a first-time home buyer, the amount of tax payable is only $1,500, or 0.32% of the purchase price.

If the rebate threshold is increased from $400,000 to $475,000, those transactions for purchases between the two values which were previously taxable are now tax exempt, and the City would incur a tax loss, estimated at $9.0 million based on 2012 data.

The tax revenue loss or "tax expenditure" associated with an increase in the maximum first-time home buyer rebate is significant, and would have to be considered in the context of other City priorities.

B. Harmonizing City's rebate policy with provincial rebate policy

Another potential policy change would be to reduce the first-time home purchaser's maximum MLTT rebate amount from $3,725 to $2,000 to harmonize with the provincial LTT policy. Under the City's current tax rates, the 'tax-free' purchase price would drop from $400,000 (corresponding to rebate amount of $3,725) to $227,500 (corresponding to rebate amount of $2,000). The portion of the price between $227,500 and $400,000 would now be taxable, resulting in an increased cost to first-time home buyers of up to $1,725, and estimated tax increase of $18.6 million based on 2012 data.

C. Eliminating the first-time home purchasers rebate

If the City eliminates the first-time home purchaser's rebate, all those transactions that previously qualified for the rebate would now pay the applicable tax of up to $3,725, resulting in an estimated tax revenue increase of $54.5 million based on 2012 data.

Eliminating the first-time home purchaser's rebate could be considered in conjunction with a general reduction in MLTT tax rates. The tax impact on any transaction, including that of a first time home buyer, would be reduced commensurately.

Tax Reduction Options:

The MLTT rates apply on a property's value of consideration in progressive tiers, and the overall rate on a transacted property is a blended rate. Table 6 shows that the blended rate for a property purchased for $500,000 is 1.145% for a taxable residential property, and 1.045% for a non-residential property.

Table 6 - MLTT on a $500,000 property

	Residential				Non-Residential			
Value of Consideration	Tax Rates	MLTT on a $500,000 property			Tax Rates	MLTT on a $500,000 property		
$0-$55,000.00	0.50%		$	275	0.5%		$	275
$55,000.01 - $250,000.00	1.00%	plus	$	1,950	1.0%	plus	$	1,950
$250,000.01 - $400,000.00	1.00%	plus	$	1,500	1.0%	plus	$	1,500
>$400,000.00	2.00%	plus	$	2,000	1.5%	plus	$	1,500
>$40 million					1.0%			
Blended rate	1.145%	Total	$	5,725	1.045%	Total	$	5,225

Administrative consideration:

The tax rates as well as thresholds are set and implemented under contract with the City's collection agent, Teranet Inc. Staff have confirmed that system changes and testing required to amend tax rates can be made relatively quickly (i.e. in a matter of weeks), but that more complex changes could require much longer lead time. The options discussed below focus on potential changes to the rates.

Potential scenarios for rate changes:

A. Capping the MLTT:

It has been suggested that capping MLTT revenues would recognize the need for predictable and stable revenue, and also achieve a gradual diminishing of the rates – similar to the manner in which property taxes are reduced each year to adjust for assessment increases. The lower rates would reduce the burden on purchasers and sellers of real estate and the Toronto real estate market over time.

Under this proposal, in a rising market, as revenues climb above a set target, tax rates could be reduced, perhaps on a set anniversary date such as during the winter 'slow' season, to maintain a stable revenue outlook. In a falling market, tax rate increases could be considered, or the revenue could be allowed to drop.

Unlike property taxes, MLTT is subject to wide seasonal and year-over-year variations in transaction volume and revenue. This creates challenges for revenue stabilization or capping. In a strong market, rates would fall dramatically in the following period, potentially resulting in significant revenue impacts to the City when the market returns to normal activity levels. Also, any regular adjustment to the rates — even relatively small changes — would be anticipated by the market, and could cause significant adjustment to the timing of transactions. Finally, reducing tax rates in a rising market, and/or potentially raising them in a falling market, could act to increase market volatility, which is not the City's objective.

B. Reducing the tax rates

The MLTT rate structures for residential and non-residential properties are different. In the ensuing paragraphs, various scenarios and the resulting financial impacts are shown separately for residential and non-residential properties.

Reduced rates in the lower rate tiers benefit all buyers, but have a disproportionate benefit to buyers of lower priced properties. Should the City introduce rate reductions as a means to reduce the tax, it would be most equitable if changes are made from the bottom up, i.e. reduce or eliminate the first tier (under $55,000) rate before changing second tier, and so on.

In the analysis below (Table 7) the rates are reduced to zero or half the current rate progressively starting from the bottom tier (under $55,000), and the estimated costs to the City and the values as percentages of 2012 net MLTT revenue are shown. It is followed by a discussion of how a 10% reduction and a 25% annual reduction to eliminate the tax over four years could be achieved.

Residential properties:

For residential properties, once rates have been reduced to zero up to the $400,000 level, a first-time home buyer rebate would be irrelevant, since any purchase under $400,000 would not be taxed. Accordingly, revenue impacts are shown where the rebate for first-time home purchasers is continued as well as eliminated.

Table 7 – Tax rate reduction scenarios for residential properties

Value of consideration & tax rates	Current	Tax Rate Reduction Scenarios 1	2	3	4	5
≤$55,000.00	0.5%	0.0%	0.0%	0.0%	0.0%	0.0%
$55,000.01- $250,000.00	1.0%	1.0%	0.5%	0.0%	0.0%	0.0%
$250,000.01 - $400,000.00	1.0%	1.0%	1.0%	1.0%	0.5%	0.0%
>$400,000.00	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%

Incremental Revenue Impacts

A Continue FTHB rebate	Scenarios 1A	2A	3A	4A	5A
Net revenue impact (+/-M)	**(5)**	**(21)**	**(38)**	**(50)**	**(63)**
Net impact as % of 2012 revenue	*-1%*	*-6%*	*-11%*	*-15%*	*-18%*

B Eliminate FTHB rebate	Scenarios 1B	2B	3B	4B	5B
Tax loss (same as A above)	(5)	(21)	(38)	(50)	(63)
Revenue increase	50	32	15	7	-
Net revenue impact (+/-M)	**45**	**11**	**(23)**	**(43)**	**(63)**
Net impact as % of 2012 revenue	*13%*	*3%*	*-7%*	*-12%*	*-18%*

Non–residential:

The commercial property market is generally less well understood. A majority of transactions occur in the under $300,000 price range, likely related to small retail properties. A reduction to the rates affecting these transactions might be considered a benefit to small business, and could be considered further in the context of the City's economic development aspirations. Table 8 summarizes the net impacts of various tax rate reduction scenarios:

Table 8 — Tax rate reduction scenarios for non-residential properties

Value of consideration & tax rates	Current	Tax Rate Reduction Scenarios 1	2	3	4	5
≤$55,000.00	0.5%	0.0%	0.0%	0.0%	0.0%	0.0%
$55,000.01- $250,000.00	1.0%	1.0%	0.5%	0.0%	0.0%	0.0%
$250,000.01 - $400,000.00	1.0%	1.0%	1.0%	1.0%	0.5%	0.0%
$400,000.01 - $40 million	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
>$40 million	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Incremental Revenue Impacts (+/-$M)		**(4)**	**(17)**	**(31)**	**(35)**	**(40)**
Net impact as % of 2012 revenue		*-1%*	*-5%*	*-9%*	*-10%*	*-12%*

Reducing the MLTT by 10%:

A 10% reduction is equivalent to reducing the tax by approximately $34 million based on 2012 data. As the tables above illustrate, this can be achieved in a variety of ways, targeting residential rates, with or without modifications to the FTHB rebate, or targeting non-residential rates, or a combination of both. Four specific options are displayed in Table 9 below.

Table 9 — Summary of potential 10% reduction options

Options	Residential		Non residential		Total revenue impact ($M)
	Revised Rates	Revenue Impact ($M)	Revised Rates	Revenue Impact ($M)	
Option 1	< $55,000 = 0% $55,000 - $250,000 = 0.1%.	(34)	No change	-	(34)
Option 2 Eliminate FTHB rebate	< $55,000 = 0% $55,000 - $250,000 = 0% $250,000 - $400,000=0.7%	(34)	No change	-	(34)
Option 3	No change	-	<$55k = 0% $55,000 - $250,000 =0% $250,000 - $400,000= 0.57%	(34)	(34)
Option 4	< $55,000 = 0% $55,000 - $250,000 = 0.57%	(19)	< $55,000 = 0% $55,000 - $250,000 = 0.57%	(15)	(34)

A 10% (or $34 million) reduction could be achieved by one of the following options:

Option 1. for residential properties only, reducing the rate on the first $55,000 to zero, and reduce the rate on $55,000 to $250,000 from 1.0% to 0.1%, or

Option 2. for residential properties only, reducing the tax rates on the first $250,000 to zero, and reducing the rate on the next tier $250,000 to $400,000 from 1.0% to slightly over 0.7%, and eliminating the first-time home purchasers rebate, or

Option 3. for non-residential properties only, reducing the tax rate on the first $250,000 consideration value to zero, and reducing the rate on the next tier $250,000 to $400,000 from 1.0% to 0.57% , or

Option 4. for all properties, reducing the rate on the first $55,000 to zero, and the second tier $55,000 to $250,000 from 1.0% to 0.57%.

These figures are based on 2012 results, and the impact will differ as the market changes over time. If Council wanted to implement a 10% MLTT tax reduction to residential buyers, then staff would recommend Option 2 because it delivers broad-based reductions to all purchasers of lower priced homes with minimal impacts to first-time home purchasers.

Eliminating the MLTT by 25% annually over four years:

A four year phase-out of the tax would be unusual in terms of advance notice of pending tax relief. The impact on the market, at least in seasonal terms, could be significant as transactions would be structured to close immediately following a rate reduction.

Elimination of the tax could also be introduced in a variety of ways. A 27% reduction would be sufficient in one year to provide across-the-board residential tax relief for transactions under $400,000 and simultaneously eliminate the first-time home buyer rebate program, together with tax relief for non-residential properties valued at up to $250,000. In subsequent years, decreases could be targeted for either residential or non-residential transaction, or both. This approach is shown in Table 10 below. The three upper tiers for non-residential properties are eliminated sequentially from the bottom up in the following three years, and rates for residential properties are proportionately decreased, resulting in approximately 26%, 24% and 23% reduction in years 2 to 4 respectively. The tax could be completely eliminated after four years. Similarly these figures are based on 2012 results, and the impact will differ as the market changes over time.

Table 10 — Blended strategy to eliminate MLTT over four years

	Residential		Non-residential		Total revenue impact ($M)	% of total revenue (2012)
	Revised Rates	**Revenue Impact ($M)**	**Revised Rates**	**Revenue Impact ($M)**		
Year 1	<=$55,000.00 = 0.0% $55,000.01 - $250,000.00 = 0.0% $250,000.01 - $400,000.00 = 0.0% First-time home buyer rebate made redundant	(63)	<=$55,000.00 = 0% $55,000.01 - $250,000.00 = 0.0%	(31)	**(94)**	27%
Year 2	>$400,000 =1.0%	(79)	$250,000.01 - $400,000.00 = 0.0%	(9)	**(88)**	26%
Year 3	>$400,000 = 0.8%	(16)	$400,000.01 - $40M = 0.0%	(68)	**(84)**	24%
Year 4	>$400,000 = 0.0%	(63)	>$40M = 0.0%	(16)	**(79)**	23%
Total over four years					**(345)**	100%

Staff will continue to review potential rate reduction scenarios as directed, and the effectiveness of the first-time home buyer's rebate in consultation with the Province, and report to the Budget Committee on potential reductions to the Municipal Land Transfer Tax rates or rebate for first-time home purchasers as part of the 2014 Operating Budget process.

The MLTT has become a key sustainable own-source City revenue since its 2008 inception. Although the City is approaching fiscal sustainability, the current 2014 operating budget outlook requires an efficiency savings target of almost $200 million, after an assumed 2% property tax increase and other user fee increases. Any reductions in the MLTT revenue would increase operating budget funding pressures and resulting expenditure program impacts for 2014 and beyond.

Staff are hesitant to amend MLTT tax rates before any consideration of the potential expenditure and program impacts. As a result, it is recommended that this report be forwarded to Budget Committee for consideration of the 2014 budget.

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SIGNATURE

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