TORONTO

REPORT FOR ACTION

Property Tax Policies for 2021

Date: January 13, 2021
To: Executive Committee
From: Chief Financial Officer and Treasurer
Wards: All

SUMMARY

This report provides recommendations for property tax policies for the 2021 taxation year. The recommendations are consistent with and further Council's longstanding objectives for tax policy, designed to ensure the continued competitiveness of Toronto's business tax classes, while affording a level of protection to property owners affected by assessment-related property tax increases.

Specifically, this report recommends continuing the policy of limiting (capping) allowable tax increases in 2021 to a maximum of 10% of a property's prior year's taxes, for any property in the commercial, industrial and multi-residential tax classes that would otherwise experience a property tax increase of greater than 10% and where the tax increase is greater than $500. The costs of capping protection will be funded by withholding (clawing-back) a portion of the tax decreases that would otherwise be experienced by other properties within each class, as has been the City's practice since 1998. These measures will ensure that no taxpayers within those tax classes will face an assessment-related tax increase that is greater than 10% of last year's property tax liability, provided the tax increase is greater than $500.

In order to ensure that progress continues to be made in moving properties to their full Current Value Assessment (CVA) level of taxation, it is also recommended that Council adopt a policy that properties that are within $500 (plus or minus) of their full CVA level of taxation in the current year be taxed at full CVA taxation levels for the year, and therefore excluded from capping/claw-back provisions for that year.

This report also responds to previous Council requests to evaluate the feasibility and financial implications of additional tax policy approaches, including adopting a small business tax class, adopting measures to address assessment volatility, re-evaluating targeted tax ratio reductions within the commercial, industrial and multi-residential classes, and revisiting the current strategies and CVA thresholds for graduated tax rates within the commercial residual tax class. Given that key provincial regulations that would allow for the adoption of a small business tax subclass and/or approaches that deal with assessment volatility have not yet been enacted, making it impossible to determine financial impacts, it is recommended that these measures be considered for implementation in the 2022 taxation year.

RECOMMENDATIONS

The Chief Financial Officer and Treasurer recommends that:

1. City Council adopt the following property tax capping polices, for the 2021 taxation year:

   a. limit tax increases for the commercial, industrial, and multi-residential property classes by capping taxes at 10% of the preceding year's annualized taxes, by opting to have subsection 292(1), paragraph 1, of the City of Toronto Act, 2006, apply for the 2021 taxation year,

   b. continue to provide that the 10% cap on tax increases apply to any property within the commercial, industrial and multi-residential classes, regardless of whether the property had reached full Current Value Assessment taxation levels in a prior year, subject to the threshold adopted in Part c. below,

   c. for the purposes of subsection 292(1), paragraphs 3 and 4 of the City of Toronto Act, 2006, adopt a threshold limit of $500 to determine the taxes for municipal and school purposes, such that properties that are within $500 (plus or minus) of their full Current Value Assessment level of taxation in the current year are taxed at full Current Value Assessment taxation levels for the year, and are therefore excluded from capping/claw-back provisions for that year.

2. City Council direct the Chief Financial Officer and Treasurer to review and report back to Executive Committee and Council during 2021 on additional tax policy options, including the potential to define a small business tax class to provide a lower tax rate for qualifying properties, and other potential measures to address impacts on properties that may be subject to large increases in assessed value based on speculative or hypothetical uses, rather than the current use of the property, all for consideration for 2022 and future years.

FINANCIAL IMPACT

There is no financial implication to the City of Toronto's budget arising from the capping policy changes recommended in this report. Under the capping and claw-back system, the foregone revenue resulting from the capping limit on Current Value Assessment (CVA)-related tax increases for properties in the commercial, industrial and multi-residential property tax classes is funded by withholding (clawing-back) a portion of the tax decreases that would otherwise be applied to other properties within each class.

It is anticipated that the recommended capping limits on tax increases will be entirely funded by tax decreases that would otherwise apply within each class. As the final claw-back rate percentages cannot be adopted until the 2021 Operating Budget has been approved by Council, and the provincial education rates adopted by regulation, these percentages will be reported to Council to approve and enact a by-law establishing the 2021 claw-back rates following final budget approval.

DECISION HISTORY

At its meeting of January 31, 2018, City Council adopted Item EX30.5: Tax Policy Tools to Support Businesses that established tax policy options for 2018. In its consideration of this item, Council also directed the Interim Chief Financial Officer to engage in public consultations to review additional property tax options for 2019 and future years, as well as any potential requests for legislative change for such options. The Executive Committee, on July 17, 2018 adopted, with amendments, Item EX36.7: Additional Property Tax and Legislative Change Options to Support Businesses, which reported on the results of the City's consultations, and which identified a number of considerations for establishing tax policies for 2019 and beyond.

Council, at its meeting of October 29, 2019, adopted Item MM11.6: Protecting Small Businesses from Condominium Speculation Assessment Tax, requesting the Chief Financial Officer and Treasurer to report to Executive Committee on "*options to support businesses to mitigate the adverse impact of 'highest and best use' valuation when using direct sales comparison approach by Municipal Property Assessment Corporation to determine Current Value Assessment for commercial properties*", and further, to meet with provincial Ministry of Finance officials "*to seek tax relief from the impact of 'highest and best use' valuation of small business properties*".

In 2020, Council adopted tax rates, education rates and claw-back rates and other tax policy decisions for the 2020 taxation year by its adoption of the following items: EX13.1: 2020 Property Tax Rates and Related Matters and CC20.4: 2020 Education Property Tax Levy and Clawback Rate By-Law and COVID-19 Tax Relief By-Law Amendments. In its consideration of Item EX13.1 above, Council made the following additional requests:

13. City Council request the Chief Financial Officer and Treasurer to request the Province of Ontario to review the "ranges of fairness" for tax ratios and regulations that tax ratios for commercial, industrial and multi-residential properties can only stay the same or be reduced but cannot be increased.

14. City Council request the Chief Financial Officer and Treasurer to report before the 2021 Budget process on the status of the ratios between property classes and progress made towards achieving the target ratio of 2.5-times the residential tax rate.

15. City Council request the Chief Financial Officer and Treasurer to report to City Council before the 2021 Budget process on the threshold for Residual Commercial tax rates for Band 1 and Band 2 of $1,000,000 and on whether the threshold can be increased and on how the rates for the two bands can be altered to better help smaller businesses.

16. City Council request the Chief Financial Officer and Treasurer to report, as part of the 2021 Budget process, on revised ratio targets that will reduce the annual tax policy shift onto the residential class arising from reduced ratios for the commercial and industrial tax classes.

Most recently, Council adopted [Item EX17.1: Towards Recovery and Building a Renewed Toronto](), which considered the recommendations contained in the *COVID-19: Impact and Opportunities* report from the Toronto Office of Recovery and Rebuild, notably recommendations 51 and 52, which were restated within EX17.1 as Recommendations 16 and 17, as follows:

16. City Council request the Chief Financial Officer and Treasurer, in consultation with the General Manager, Economic Development and Culture, to report to City Council through the 2021 Budget process with options for updating the existing $1,000,000.00 threshold between Residual Commercial tax bands and adding an additional band to support main street businesses.

17. City Council request the Chief Financial Officer and Treasurer, in consultation with the General Manager, Economic Development and Culture, to report to City Council through the 2021 Budget process with an update on the City's work with Municipal Property Assessment Corporation and the Ministry of Finance to reduce the volatility of commercial property assessments and support main street businesses.

COMMENTS

Toronto's current tax policies are shaped by legislative and regulatory requirements set out in the *City of Toronto Act, 2006* (COTA) and the *Assessment Act*, and by Council's previously adopted tax policy measures. Mandatory limitations on annual allowable tax increases (tax capping) and the withholding of tax decreases (claw-backs) for properties in the commercial, industrial and multi-residential tax classes have been in place since 1998.

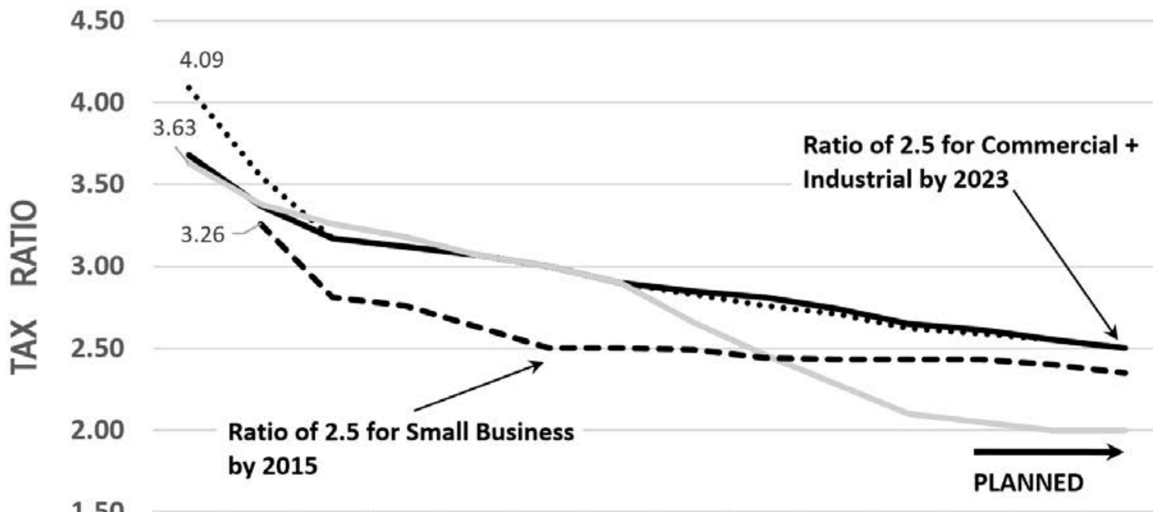
Progress in Reducing Tax Ratios for Businesses

In 2005, Council adopted the staff report: [Final Recommendations - Enhancing Toronto's Business Climate – It's Everybody's Business](), which approved, among other things, a long-term strategy to systematically reduce tax rates within the commercial, industrial and multi-residential tax classes, to ensure the continued competitiveness of Toronto businesses vis-à-vis other areas of the GTHA.

Council's long term objective was set to achieve a tax ratio for businesses of 2.5 times the residential rate by 2020 (later changed to 2023 by a 2017 Council decision). In 2007, Council also approved that tax ratio reductions be accelerated for that portion of a property's assessed value less than $1 million for properties in the new Residual Commercial Tax class to reach a target tax ratio of 2.5 times the residential rate by 2015, as a means of providing accelerated tax reductions for smaller businesses. This target was achieved for the 2015 taxation year.

Toronto remains on track to achieve its stated target ratio for the commercial and industrial tax classes of 2.5 times the residential rate by 2023, as shown in Figure 1.

Figure 1: Tax Ratio Reductions in Toronto, 2006-2020, Toronto



	2006	2009	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Commercial	3.68	3.37	3.17	3.12	3.07	3.00	2.90	2.85	2.81	2.74	2.65	2.61	2.55	2.50
Industrial	4.09	3.55	3.17	3.12	3.07	3.00	2.90	2.83	2.76	2.71	2.62	2.59	2.55	2.50
Multi-residential	3.63	3.38	3.26	3.18	3.07	3.00	2.90	2.66	2.46	2.28	2.10	2.05	2.00	2.00
Small Business		3.26	2.81	2.76	2.63	2.50	2.50	2.49	2.44	2.43	2.43	2.43	2.40	2.35

This systematic reduction in tax rates and tax ratios has resulted in a reduction of the total tax burden borne by the business classes (commercial, industrial and multi-residential), through gradual and incremental shifts of the tax levy to the residential class. This shifting of the tax burden is accomplished primarily via 2 means:

i) by passing on a reduced share of the City's annual municipal budgetary levy increase in each year. For example, where the residential class faces a budgetary tax levy increase of 2%, the City's practice since 2017 has been to pass on a tax levy increase of half of the residential increase percentage to the commercial class (a 1% increase); one-third of the residential increase to the industrial class (a 0.67% increase); and a zero percent increase to the multi-residential class (as mandated by provincial regulation).

ii) by adopting an annual shift of tax burden to the residential tax levy (about $3 million in 2021), referred to as a "policy shift" when establishing tax ratios and rates, to ensure that the ratio reduction targets for each year are met in order to maintain progress towards Council's stated business tax ratio of 2.5 times residential by 2023.

Since the Province mandated a freeze on the multi-residential tax class in 2017, the multi-residential ratio has dropped faster than initially planned, resulting in a larger tax burden being borne by each of the rest of the tax classes, including residential.

Modifying Tax Ratio Targets

Council, in adopting Item EX13.1: 2020 Property Tax Rates and Related Matters in February 2020, directed the Chief Financial Officer and Treasurer, among other things, to *"request the Province of Ontario review the* "ranges of fairness" *for tax ratios … with respect to the regulations …. that require that business tax ratios can only stay the same or be reduced but cannot be increased* (Recommendation 13)*.*

City of Toronto staff have served as co-chair and regular participants in the Province's Property Assessment and Taxation Review Municipal Advisory Committee (PATRMAC) in 2019 and 2020 and have raised the issue of the current restrictions on tax ratios. The Province has not, to date, announced that it is contemplating changes to the current regulations related to tax ratios, including the current limitation from passing on any form of budgetary levy increase to the multi-residential tax class for municipalities whose tax ratio for that class is above 2.0. Toronto's 2021 tax ratio for multi-residential is estimated to be in the range of 2.05 to 2.10, therefore it is anticipated that the freeze on the multi-residential tax burden will continue to apply in 2021.

In respect of Council's request in Item EX13.1 (Recommendation 14) to report on the status of the ratios between property classes and progress made towards achieving the target ratio of 2.5-times the residential tax rate, this information is provided above and in Figure 1.

Council further requested in Item EX13.1 (Recommendation 16) a report back as part of the 2021 Budget process *"on revised ratio targets that will reduce the annual tax policy shift onto the residential class arising from reduced ratios for the commercial and industrial tax classes".* Staff are recommending that the ratio targets for 2021, and the associated tax policy shift onto the residential class continue to be set to achieve Council's objective of reaching a tax ratio for the commercial and industrial classes of 2.5 times the residential rate by 2023. This will maintain Council's original and long-standing objective adopted in 2005.

The tax policy shift onto the residential class for 2021 will be set at the minimum amount necessary to achieve the ratio reduction target. This amount will be reported in the staff report *2021 Property Tax Levy and Related Matters* scheduled to be presented to the February 11, 2021 Executive Committee meeting.

Maintaining tax ratio reductions of about 0.05 a year over the 2021-2023 period will allow for a gradual reduction of the commercial and industrial class tax ratios until the target ratio of 2.5 is achieved in 2023. Given that steady downward progress has been maintained in each year since 2005, it is not recommended that progress be suspended or slowed down further with only 3 years remaining to achieve the target.

Once the 2023 target has been reached, Council may then consider whether further targeted ratio reductions will be pursued. During tax policy consultations with business stakeholders held in 2018, (ref. Item EX36.7) 94% of respondents agreed that business tax ratios should continue to be reduced, with 93% of respondents suggesting that progress in ratio reductions should be accelerated, rather than maintaining or reducing the current pace of reductions.

Caps on Tax Increases

Tax capping refers to the practice of prescribing a maximum allowable limit on year-over-year increases in property taxes. Originally intended as a temporary transitional measure to mitigate large property tax increases arising from the introduction of the Current Value Assessment system, tax capping has been in place in Toronto since 1998. Under COTA, capping is mandatory for properties in the commercial, industrial and multi-residential tax classes, although municipalities have some flexibility in setting the tax capping parameters.

In order to recover the tax revenue foregone by the capping limits on properties experiencing tax increases, provincial legislation and regulations permit municipalities to withhold a portion of the tax decrease that would otherwise apply to properties that have experienced an assessment-related tax decrease, i.e., the "clawing-back" of decreases. Each year, Council establishes a claw-back rate for each class that prescribes the percentage of the tax decrease that must be withheld (clawed-back) to fund the costs of capping protection.

Tax capping has proven to be an effective tool to mitigate large tax increases, and the rules surrounding capping and claw-back are now generally well understood by business property owners and the legal community and real estate and tax professionals that represent them.

Toronto's Current Tax Capping Policies

From 2006 to 2016, Council adopted a capping limit of 5% of the prior year's CVA-level taxes. In 2017, in order to accelerate progress towards full CVA taxation, Council approved an increase in the capping limit to 10% of the prior year's full CVA. In 2018, 2019 and 2020, Council approved a capping limit of 10% of a property's annualized taxes.

"Annualized taxes" refers to the actual amount of taxes levied in the year, or in the case of properties where, during the taxation year, a change in taxes occurred that applied to a portion of the taxation year (e.g., due to assessment or other appeals, a change in tax status, or a change in the assessed value of the property arising from new construction, improvements, renovations, demolitions, change in zoning, etc.), annualized taxes refers to the taxes that would have been payable had the change applied to the full year.

Toronto Council's long-term property tax policies have also included, since 2009, provisions to accelerate progress towards full Current Value Assessment (CVA) taxation levels for non-residential properties, by removing properties from the capping and claw-back system once they reached their full CVA level of taxation. This policy saw a gradual but steady increase in the number of properties paying taxes at full CVA levels, and a reduction in the number of properties subject to capping/claw-back.

In 2017, however, properties that had reached their full CVA taxation levels were no longer eligible for capping protection - this, combined with the impact of a province-wide reassessment and new CVA values, resulted in many property owners experiencing large and unmitigated tax increases as a result of assessment changes.

In 2018 to 2019, Council adopted changes to mitigate extraordinary tax increases by limiting tax increases to 10% of the prior year's annualized taxes, but also to extend tax capping protection to *all* non-residential properties, regardless of whether they had reached full CVA taxation levels in a prior year. This ensured a level of protection against tax increases due to assessment changes for all business properties.

Continuing Caps on Tax Increases for 2021

This report recommends that Council continue to cap property tax increases in 2021 to a maximum of 10% of a property's prior year's annualized taxes, for any property in the commercial, industrial and multi-residential tax classes that would otherwise experience a property tax increase of greater than 10% and where the tax increase is greater than $500.

It is further recommended that the costs of capping protection continue to be funded by withholding (clawing-back) a portion of the tax decreases that would otherwise be experienced by other properties within each class, as has been the City's practice since 1998. These measures will ensure that no taxpayers within the business tax classes will face an assessment-related tax increase that is greater than 10% of last year's property tax liability, provided the tax increase is greater than $500.

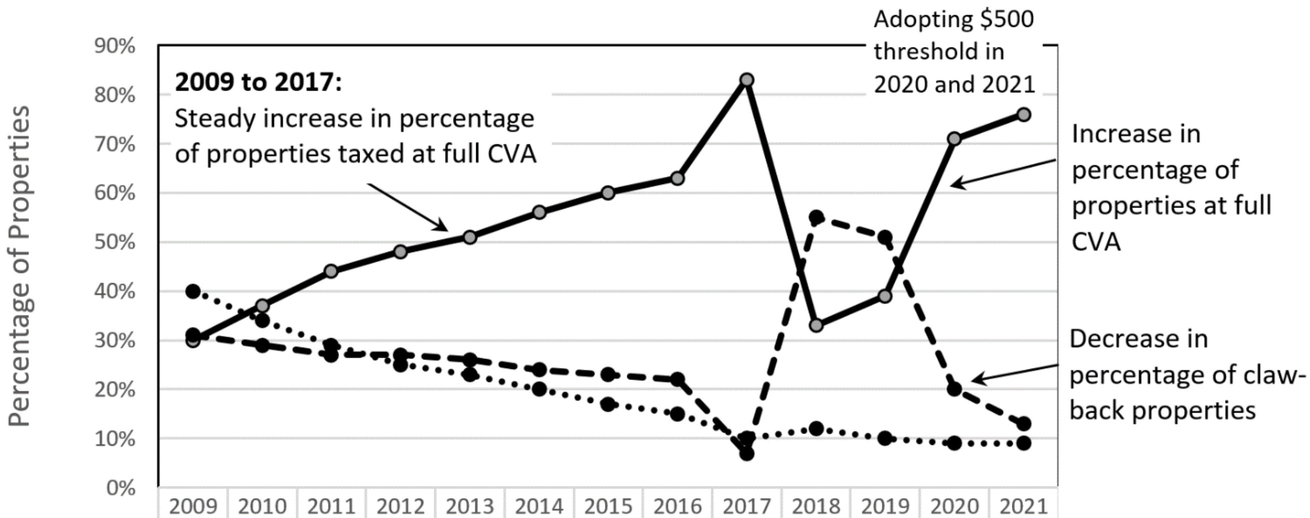
In order to ensure that progress continues to be made in moving properties to their full Current Value Assessment (CVA) level of taxation, it is recommended that Council adopt a policy that properties that are within $500 (plus or minus) of their full CVA level of taxation in the current year be taxed at full CVA taxation levels for the year, and therefore excluded from capping/claw-back provisions for that year.

Combined, the recommendations above will provide a level of protection against tax increases for Toronto's businesses in 2021, but more importantly, maintaining a $500 threshold (plus or minus) within which properties are taxed at full CVA taxation levels will continue to ensure that progress is made in reducing the number of properties subject to caps/claw-backs, and increasing the number of properties that are paying their full CVA level of taxes (i.e., property taxes = CVA times tax rate). This is an important measure of equity and fairness in taxation.

Toronto's progress in moving properties to full CVA taxation levels and reducing the number of properties subject to caps/claw-backs is illustrated in Figure 2 below. Steady progress in the number of properties taxed at full CVA levels is observed from 2009 to 2017. This progress was interrupted in 2018 and 2019 as a result of a change in tax policies that extended capping protection to all properties (including those already at full CVA taxation levels), and where no threshold applied.

The adoption of the $500 threshold in 2020 saw an immediate increase in the number of properties taxed at full CVA taxation levels, and a reduction in the percentage of properties subject to claw-back. It is projected that continuing the application of the $500 threshold in 2021 will see a further increase in the number of properties taxed at full CVA levels.

Figure 2: Percentage of properties taxed at full CVA, and percentage of properties subject to capping or claw-back, Commercial Class, 2009 to 2021 (projected), with $500 threshold applied



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Full CVA	30%	37%	44%	48%	51%	56%	60%	63%	83%	33%	39%	71%	76%
Capped	40%	34%	29%	25%	23%	20%	17%	15%	10%	12%	10%	9%	9%
Claw-back	31%	29%	27%	27%	26%	24%	23%	22%	7%	55%	51%	20%	13%

It is also acknowledged that caps on tax increases will likely continue to serve as a necessary element of a comprehensive property tax strategy in 2021 and subsequent years. Caps on tax increases will be required to mitigate the impacts of a new assessment base year (possibly in 2022 or 2023), and particularly where assessment increases may reflect valuations based on "highest and best use", rather than current use, as discussed later in this report.

Changes to Commercial Graduated Tax Rate Bands

Graduated tax rates allow different tax rates to apply to different portions of the total assessed value of a property. Currently, the City of Toronto applies graduated tax rates to properties in the commercial residual tax class. A lower tax rate applies to the first million dollars of CVA (Band 1), while a higher tax rate applies to any portion of a property's total CVA above $1,000,000 (Band 2). The tax rate differential between Band 1 and Band 2 rates in 2020 is approximately 8.4%. The commercial residual class includes most commercial properties but excludes properties classified within the large office, large shopping centre, professional sports complexes, parking lots and commercial vacant land property classes.

Under a system of graduated tax rates, lower valued properties receive more of a benefit from the reduced tax rate that applies to Band 1. However, higher valued properties pay a greater proportion of taxes, and consequently tenants, including small businesses which may reside in larger buildings, will pay higher taxes than those in lesser valued buildings. As such, graduated tax rates are not particularly effective as targeted tax policy tools, especially with respect to small business tenants.

Graduated tax rates for commercial properties are permitted under the City of Toronto Act, and up to 3 distinct bands of assessment may be specified. As such, it is within the City's authority to have different banding thresholds apply, to vary the percentage difference between Band 1 and Band 2 rates, or to introduce 3 bands of assessment.

In 2020, Council, in considering Item EX13.1 (Recommendation 15) and Item EX17.1 (Recommendation 16), requested a report back on options for updating the existing $1,000,000 threshold between Residual Commercial tax bands and adding an additional band to support main street businesses.

In considering graduated tax rates, Council must consider that the total taxes levied across the broad commercial class cannot be increased (under the current regulatory tax ratio restrictions). As such, tinkering with graduated rates becomes a balancing exercise. If the tax burden is reduced for Band 1, the tax burden for Band 2 must be increased by a similar amount. Similarly, if the CVA threshold is increased to allow more properties to receive the benefit of a lower rate, then a smaller number of medium and larger properties bear a proportionately larger share of the commercial tax levy.

During earlier stakeholder consultations, one of the options proposed was increasing the Band 1 threshold from $1 to $2 million. Further analysis showed that this approach would provide a modest benefit for properties with assessment between $1 and $2 million (6,000 properties), provide no benefit to properties with a total CVA of less than $1 million (24,000 properties), and an increase to the tax burden for properties with assessment above $2 million (7,000 properties).

Another scenario analysed increased the Band 1 and Band 2 tax rate differential to 20% between Band 1 and Band 2. This would have again resulted in a modest benefit to properties with CVA below $1 million (an additional 1.4% decrease in taxes) but a more significant (about 5%) increase in taxes to properties with CVA above $1 million. Since both scenarios provide only modest benefits to certain properties, while negatively impacting others, these options were not considered further.

Even eliminating the current graduated rates within the commercial residual class, i.e., by collapsing the 2 bands into a single uniform rate, would by itself result in the equivalent of a tax increase on those properties who currently enjoy a tax reduction on the portion of assessment less than $1 million.

It is also important to note that while graduated tax rates could provide a lower tax rate to lower-valued properties, they do not provide protection against large assessment-related tax increases - in fact, graduated tax rates would likely exacerbate the impact of such increases on medium- to high-valued properties that have a higher proportion of their assessment taxed at the Band 2 (or Band 3) rate. Hence caps on tax increases would still be required, and the benefit of graduated tax rates would be minimal or non-existent to properties facing large increases. This consideration is especially important given that the next province-wide reassessment and updated assessed values will take place for the 2022 or 2023 taxation year (pending a provincial decision).

Additionally, with the Provincial Budget announcement of November 5, 2020 that offers the ability for municipalities to define and adopt a small business tax class, with tax rate reductions of up to 35% of the otherwise applicable commercial tax rate, this presents the opportunity to design and deliver a much more targeted and focused means of providing tax relief to small businesses that more closely aligns with Council's economic development strategies and priorities. As regulations that would allow the small business tax subclass to be adopted have not yet been enacted, this report recommends that the Chief Financial Officer and Treasurer be requested to report back on the feasibility, eligibility criteria and financial implications of adopting a small business tax class for the 2022 taxation year.

Therefore, given that any change to graduated rates would likely only apply to the 2021 taxation year and then be replaced by a small business tax class in 2022, and that any changes for 2021 would produce minimal benefits to lower valued properties while resulting in increased taxation levels for medium and higher valued properties, no changes are being recommended to the current system of graduated rates for the 2021 taxation year. The forthcoming staff report *2021 Property Tax Levy and Related Matters* scheduled to be considered at the February 11, 2021 Executive Committee meeting will include the recommendation that Council continue the adoption of two bands of assessment of property in the Residual Commercial Property Class in 2021, for the purposes of facilitating graduated tax rates, with a similar rate differential as that adopted for 2020.

Volatility of Assessments and Assessment at Highest and Best Use

The Provincial Budget announcement of November 5, 2020 (Protect, Support and Recover from COVID-19 Act (Budget Measures), 2020) identified that the Ontario Government, in response to concerns regarding redevelopment and speculative sales, has proposed amendments to the *Assessment Act* to support the potential creation of optional new assessment tools to address concerns.

Currently, the *Assessment Act* authorizes the Minister to make regulations determining how the current value of land is established for assessment purposes, including when land is assessed based on its current use, as opposed to its "highest and best use". The amendments proposed by the November 2020 Provincial Budget Act are expected to provide municipalities with the authority to opt, by by-law, when, where and how such regulations may apply within the municipality. It is also expected that the Ministry of Finance will be conducting further consultations with the Municipal Property Assessment Corporation (MPAC), municipalities and business stakeholders to clarify how these provisions could apply.

Toronto City Council has previously made numerous requests for reports on options to address the problems of the volatility of assessment increases, including those arising from speculative sales, or the use of 'highest and best use' valuations in determining assessments, particularly as they apply to small business properties, as identified in the Decision History section of this report.

In establishing assessed values, MPAC is required to assess a property on its most likely market value, or the amount that it would transact for in an open market sale. In certain cases, a property's market value may be influenced by its potential for redevelopment rather than its current use. In such cases, a property’s value in exchange, and its resulting assessed value may reflect its "highest and best use," i.e., the expected market value or sale price of the property based on its maximum potential redevelopment value, considering the maximum density, height, etc. permitted by the site's zoning and other considerations. The Appraisal Institute of Canada defines highest and best use as "the reasonably probable and legal use of vacant land or an improved property that is physically possible, appropriately supported, financially feasible, and that results in the highest value."

Where actual market sales of property or neighbouring properties are used to derive the theoretical market value, these sale prices are the best indicator of probable market value. Ignoring actual market sales (even those considered to be speculative) and instead imputing a hypothetical "value in use" based on the property's current use to arrive at an assessed value results in a disparity in the way certain properties are valued, and has the potential to introduce and exacerbate inequities in taxation levels.

To ensure consistency with the principle that properties be assessed at their "true" market value as a means of equitably distributing the property tax burden (a principle with which the City agrees), the use of new regulatory provisions that would allow the City to designate when, where and how a property should be valued on its current use, rather than its indicated market value, will have to be carefully studied and considered.

However, given that these provincial regulations have not yet been enacted, the impacts will be difficult to predict and evaluate. It is proposed that City staff model potential impacts during 2021, once the regulatory provisions have been enacted, with any implementation of new options to mitigate assessment increases to apply in 2022 or subsequent years.

As a result of the COVID-19 pandemic, the Province postponed the implementation of the next province-wide reassessment and the updating of assessment values to a new base year that was to have applied starting January 1, 2021. Therefore, with no change in valuation base year, assessment values for the 2021 taxation year will be the same as last year, except where there have been changes to a property that affect its market value (i.e., demolition or new construction), and no properties will be facing extraordinary increases in assessed value due to market changes.

The Province has yet to announce when the next province-wide assessment will apply for taxation purposes, nor what the new valuation base year will be. Capping protection against tax increases will also continue to apply in 2021. As such, and until these decisions are made by the Province, the City need not implement any new tax policies in the short term designed to mitigate the impact of assessment changes.

This report recommends that the Chief Financial Officer and Treasurer report back on potential measures to address impacts on properties that may be subject to large increases in assessed value based on speculative or hypothetical uses, for consideration for 2022 and future years.

Creation of a Small Business Tax Class

The Provincial Budget announcement of November 5, 2020 (Protect, Support and Recover from COVID-19 Act (Budget Measures), 2020) also included the prospect of a new authority for municipalities to adopt and design a special tax subclass for small business properties, with eligibility criteria to be established by municipal by-law, to allow reduced tax rates to apply to eligible properties.

The Province's communications also identify that municipalities will be able to apply to have the Province match the municipal tax rate reduction, with a corresponding education tax rate reduction to apply to the subclass, for example, a 10% reduction in the municipal tax rate for the small business subclass would be matched by a corresponding 10% education rate reduction (in addition to the general province-wide education tax rate reductions identified for 2021 in the budget announcement).

Toronto has long advocated the need for a small business tax class that could allow tax rate reductions for small and independent businesses that are most directly impacted by market conditions, fluctuating market value assessments and more recently, COVID-19-related business slowdowns and closures. A small business subclass will allow Toronto Council to direct property tax relief in ways that are consistent with Council's objectives and priorities for economic development, in areas where it is needed most, and to benefit business tenants under net leases as well.

Staff are not recommending that a small business subclass be adopted for the 2021 taxation, but rather, that the matter be studied over 2021, and impacts modelled, and consultations held with Toronto's business stakeholder groups and business property owners that would see the small business tax subclass adopted for the 2022 taxation year. Key provincial regulations that set out how small business tax rate reductions could be funded (e.g., across one, some or all tax classes), and what criteria may be used to determine eligibility, and MPAC's role in the process, have yet to be released, making it impossible to project the financial impacts of adopting a small business subclass.

Providing staff time to study potential options and model impacts, and to hold consultations with business stakeholders and with Economic Development & Culture division, will allow for a prudent and coordinated approach. As such, this report recommends that the Chief Financial Officer and Treasurer report back on the potential to define a small business tax class to provide a lower tax rate for qualifying properties, for consideration for 2022 and future years.

Summary of Recommended Changes to Tax Policies for 2021

This report recommends that Council continue to limit allowable tax increases for the commercial, industrial, and multi-residential property classes in 2021 to 10% of the preceding year's annualized taxes, consistent with the capping rules applied in 2018 through 2020.

It is further recommended that Council adopt a threshold of $500, such that properties whose taxes that are within $500 (plus or minus) of their full CVA level of taxation in the current year be taxed at full CVA taxation levels for the year, and therefore excluded from capping/claw-back provisions for that year, and that the cap of 10% of the previous year's annualized taxes on tax increases apply to any property within the commercial, industrial and multi-residential classes, regardless of whether the property has reached full CVA taxation levels in a prior year, subject to the above threshold.

These measures will ensure a level of protection against unmanageable increases, while providing certainty and predictability for property owners and business tenants, such that no taxpayers within the business tax classes will face an assessment-related tax increase that is greater than 10% of last year's annualized property taxes, provided the tax increase is greater than $500, and excluding budgetary rate increases.

Additionally, it is recommended that the Chief Financial Officer and Treasurer report back to Executive Committee and Council on additional tax policy options during 2021, including the potential to define a small business tax class to provide a lower tax rate for qualifying properties, and other potential measures to address impacts on properties that may be subject to large increases in assessed value based on speculative or hypothetical uses, rather than the current use of the property, for consideration for 2022 and future years.

Staff are expecting to report to the February 11, 2021 meeting of Executive Committee, on recommended municipal tax rates and other property tax-related matters, and to a subsequent meeting of the Executive Committee or directly to Council or a special meeting of Council if necessary, on the 2021 tax rates for school purposes, and the 2021 percentage of the tax decreases required to recover the revenues foregone as a result of the cap limit on properties in the commercial, industrial and multi-residential property classes (the 2021 ‘claw-back’ rates).

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SIGNATURE

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