TORONTO

Casey Brendon
Director, Revenue Services

Heather Taylor
Chief Financial Officer & Treasurer

Revenue Services
North York Civic Center
5100 Yonge Street
Toronto, ON M2N 5V7

Tel:(416)392-8065
Fax:(416)696-3778
Casey.Brendon@toronto.ca
www.toronto.ca

2023 OPERATING BUDGET BRIEFING NOTE Revenue Options: Municipal Sales Tax and Municipal Income Tax

Issue/Background:

During Budget deliberations on January 12, 2023, the Budget Committee requested the Chief Financial Officer and Treasurer provide a briefing note on the estimated revenues from the following revenue tools, which would require Provincial and/or Federal legislative changes or implementation, and the equivalent operating budget property tax increases that would be necessary to generate the same amount of revenues as each of these revenue tools:

- a 1 percent municipal sales tax;
- a municipal income tax;
-

Key Points:

Municipal Sales Tax

- A municipal sales tax is not permitted under the City of Toronto Act ("COTA"). The implementation of a Municipal Sales Tax (MST) would require provincial approval and legislation. Currently there is no precedent in Ontario for a MST.

- The City commissioned KPMG in 2016 to assess potential revenue from a MST along with other revenue tools. The study assumed a flat MST rate that would apply to a basket of goods and services defined by the City and that implementation, administration and compliance costs would likely be significant. In their calculations of annual revenue estimates, KPMG assumed $18 million in annual administration expenses by the City.

Revenue Estimates of Municipal Sales Tax

The net annual revenue of a 1% municipal sales tax is estimated to be upwards of $360 million, depending on the economic recovery of the City of Toronto.

- Based on pre-COVID 2018 retail sales data, it is estimated that the average Torontonian household would see an increase of approximately $231 per year on their total expenditures with the introduction of a 1% sales tax. At the same tax rate, approximately $91.1 million of the potential tax revenue would be paid by non-residents.

- In order to generate $360 million in revenues – for comparison purposes a property tax increase of approximately 9.16% is required.

- Implementation of a non-refundable municipal sales tax, separate from the HST, would require support and administration at the provincial and federal levels.

- The 2016 KPMG study assumed that $18 million in annual administration expenses by the City would be incurred. The implementation phase would require significant policy design and implementation planning, corresponding IT infrastructure, and development of compliance and enforcement measures.

- Consideration of any retail sales tax should take into account the disproportionate impact on lower income individuals and households and mitigate these effects through mechanisms such as tax exemptions on necessities or rebate programs.

- If a sales tax were implemented only in Toronto it would introduce challenges and business impacts resulting from different sales taxes on either side of the municipal border. The impact of this will vary for different retailers. Retail locations selling high value items – e.g., motor vehicles, electronics, appliances and furniture, - could see higher levels of avoidance.

Municipal Income Tax

- The City is prohibited from imposing income taxes under COTA, and implementation would require legislative approval by the Province.

- Income taxes can be levied either on businesses or on individuals and could be collected, under agreement with the City, by the Federal government through Canada Revenue Agency (CRA).

- The following sections provide estimates of potential taxation revenues associated with a Municipal Income taxes for Business, and a Municipal Income taxes for individuals.

Business Municipal Income Taxes

Revenue Estimates of Business Municipal Income Taxes

Table 1: City of Toronto Corporate Income Tax Revenue Estimate by Rate ($ Millions)

Effective Tax Rate	**0.5%**	**0.75%**	**1.00%**	**1.25%**	**1.5%**	**1.75%**	**2.00%**
Revenue Estimate - Gross	155.1	232.7	310.2	387.8	465.3	542.9	620.4
Avoidance Deduction (5.0%)	(2.3)	(3.5)	(4.7)	(5.8)	(7.0)	(8.1)	(9.3)
Administrative Costs (1.5%)	(7.8)	(11.6)	(15.5)	(19.4)	(23.3)	(27.1)	(31.0)
Net Annual Revenue Potential	**145.0**	**217.5**	**290.0**	**362.6**	**435.1**	**507.6**	**580.1**

Revenue estimates have been based on data for 2012, which is the most recent available, and have not made adjustments for economic growth since that date. Key inputs are as follows:

- Total taxable income earned by corporations in Ontario in 2012 was $125.4 billion.

- Toronto's share of GDP in Ontario in 2015 was 24.7%.

- Toronto's share of GDP in 2015 was used as a proxy for the share of Ontario taxable income that would be allocated to the City of Toronto under any regime. The share could be based on a formula similar to that used to allocate income among provinces. For most industries, this formula uses the share of employment and revenue in any jurisdiction.

- Based on the city's share of GDP, it has been estimated that the taxable income allocated to the City of Toronto would be $31.0 billion.

Equivalent operating budget property tax increases that would be necessary to generate the same amount of revenues

Effective Tax Rate	0.5%	0.75%	1.00%	1.25%	1.5%	1.75%	2.00%
Net Annual Revenue Potential (millions)	145.0	217.5	290.0	362.6	435.1	507.6	580.1
Approximate Property Tax Increase required	**3.69%**	**5.53%**	**7.38%**	**9.23%**	**11.07**	**12.92%**	**14.76%**

Personal Municipal Income Tax

There are two broad options for taxing residents:

- a tax on residents' taxable income; or
- a tax on residents' employment income.

- Based on Ontario returns filed in 2013, the average taxable income per filer in the province was about $40,700.

- For a Toronto resident with a similar amount of taxable income, a flat income tax levy of 1% would thus cost about $400.

- In practice, the City could choose to implement a progressive income tax regime, similar to those used by the federal and provincial governments, although this would require higher rates at higher levels of income to achieve the same overall level of revenue. Higher tax rates at higher income levels would magnify the distortions associated with the resulting incentives to move employment or residential location outside of Toronto.

- Data for 2009 compiled from Statistics Canada by the Conference Board suggests that employment income for Toronto residents was about 63% of taxable income. This was lower than in all adjacent municipalities. (For example, employment income represented 73% of taxable income for residents of Mississauga.) For Toronto residents, a payroll tax levy based on employment earnings would therefore collect only about 63% of the revenue as a similar levy on taxable income.

- Certain inputs have been used to develop annual revenue estimates from the various pools of taxpayers (and associated amounts for employment earnings or taxable income) by assuming that a 1% tax rate is applied to each segment. It should be noted that the revenue amounts associated with a levy on taxable income should be assumed to be an alternative to amounts raised by a levy (or payroll tax) on employment earnings.

- It has been assumed that the City would apply a tax on one or the other (employment earnings or taxable income) but not to both at the same time.

Revenue Estimates of Personal Municipal Income Taxes

- The City would earn estimated net annual revenues of $580 million by taxing the employment income of residents (at a 1% rate).

- Alternatively, the City could earn estimated revenues of $926 million by applying a similar levy on taxable income.

- With some form of payroll tax, the City could earn an additional $208 million from inbound commuters (on top of the $580 million from residents). Thus, potential net revenues from a payroll tax could total $788 million annually.

- Looking just at Toronto residents, the gains from levying a tax on taxable income, rather than just employment earnings, are $346 million (calculated from figures in the first bullet above). The gains from levying a 1% tax on employment earnings from nonresident commuters is less, at $208 million. This may suggest that applying a broad tax base to existing residents has more revenue impact than seeking to tax commuters (notwithstanding potential equity concerns with not taxing non-resident commuters).
- It has been assumed that the City would not have the opportunity to apply a levy on the taxable income of in-bound commuters, so no additional revenues are shown from “commuter” traffic, beyond those raised by a tax on employment earnings (assumed to be collected through businesses).

Other considerations:

- It has been assumed that the City would incur costs of 1.5% of revenues for administration of the tax. Most likely, this would consist of payments to the CRA to administer the tax on its behalf. The 1.5% allowance is arbitrary but appears reasonable in light of the reported costs of administering tax systems generally. For example, the OECD reports that tax administration costs in Canada amount to about 1.3% of the net revenues collected.
- Net annual revenues have been reduced by 5% to account for avoidance and behavioural change. This value is also arbitrary.

Equivalent operating budget property tax increases that would be necessary to generate the same amount of revenues

- In order to generate $580 million in revenues – a property tax increase of approximately 14.76% is required.
- In order to generate $788 million in revenues – a property tax increase of approximately 20.1% is required.
- In order to generate $926 million in revenues – a property tax increase of approximately 23.56% is required.

Prepared by: Casey Brendon, Director, Revenue Services Division, 416-392-8065, Casey.Brendon@toronto.ca

Further information: Andrew Flynn, Controller, Finance & Treasury Services, 416-392-8427, Andrew.Flynn@toronto.ca

Date: January 18, 2023