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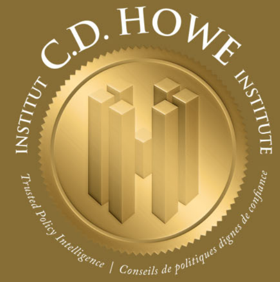

From: Benjamin Dachis

To: Toronto Mayor Olivia Chow

Date: July 21, 2023

Re: **Stuck in a Hole, and the Land Transfer Tax isn't Your Way Out**

Congratulations on your victory last month. As you take charge in your first full week, there's much conversation about the city's large financial problem. The most recent operating budget passed by council assumed about $1 billion would come in provincial or federal support to fill an operating budget hole. Hundreds of millions of dollars of that total have yet to materialize on firm commitments.

So, the city needs to find money for that hole. Where do you find that?

Your campaign promised new graduated Land Transfer Tax (LTT) rates on purchases of homes valued at over $3 million, $5 million, or $20 million.

The City of Toronto is the only municipality in the province that has the authority to impose its own LTT, and in 2017 it introduced a new top marginal rate of 2.5 percent of the value of homes above $2 million. The provincial LTT, which also applies outside of Toronto, applies the same rates to the same brackets.

Studies have generally found that LTTs have a relatively high economic cost because they discourage people from moving to more favourable locations or housing when they can do so. Instead, owners stay longer in their home, electing perhaps to renovate it. Based on an estimate of the impact of the LTT on land transfers in Toronto, a study I co-authored with Jack Mintz and Bev Dahlby in 2021 found that the current combined rate of 5 percent on homes in excess of $2 million is highly damaging to the housing market.

To gain some appreciation of how harmful that top LTT rate is, we calculated the economic cost of reduced activity from the LTT using a method called the marginal cost of funds (MCF). If the combined rate were reduced from 5 percent to 4 percent the MCF would still be 10.49, higher than estimates of the MCFs for Ontario's corporate income tax of 2.62 and personal income taxes of 6.76 based on 2020 tax rates. This confirms the widely held view among economists that the LTT is a high-cost source of tax revenues.

The current rate is close to the rate that maximizes total LTT revenues for the city and province combined. With an increase in the top tax rate, the number of transactions will decline and therefore provincial LTT revenues will decline. In other words, if Toronto increased its top rates, its revenues would increase from the incremental extra revenue. But the government of Ontario's revenues would decline by more than Toronto's increase because it loses every dollar it would have collected on sales that no longer go forward due to the higher tax.

A higher Toronto LTT will mean less, not more, collective government revenues to fund critical services. This is particularly important given that you're asking the province to fill in a large chunk of the existing budget hole. Where should it get the money if the actions of Toronto end up draining provincial coffers?

What other options might you have?

If you turn towards Toronto's year-end financial statements, you'll see that Toronto ran a $1.8 billion surplus in 2022. Why is that? And can you access some of those funds?

The reason for this end-of-year surplus (which happens every year) is hard to fully disentangle as Toronto's budgets are on a different accounting basis than year-end statements. Toronto's budgets count cash in and cash out. Year-end statements are on an accrual accounting basis. That's a problem you can fix.

A major cause of this surplus in your financial statements is that revenues that the city collects for capital expenses are coming in sooner than residents are getting back from those investments. An annual surplus means a generation of taxpayers are paying more for the services than they are receiving. This surplus only appears in financial statements because they re-express capital expenses – which have large upfront sticker costs – into annual amortization costs. Amortization allows you to see how the capital cost of an asset gets spread over its life.

And the bottom line is that Toronto residents pay about 12 percent more in taxes ($1.8 billion out of $15.7 billion total revenue) than they get back in services.

The tricky part is fixing this. The place to reduce this surplus is to rethink how you finance infrastructure. That means lowering upfront development charges. It means less reliance on provincial and federal capital grants. It means more reliance on long-term financing for long-term assets and paying for assets over time as they are built.

That takes us back to the best way to deal with current financial pressures: the property tax and user fees. These are the bread and butter of Canadian municipal government. They aren't popular, but they are how residents can pay for exactly the services they get when they are getting them.

Relying on property taxes and user fees to pay for the services residents are getting is the solution to today's budget hole and the long-term capital costs for our city.

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