Practice Paper
Implications of the Toronto Land Transfer Tax
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The impact of the Toronto Land Transfer Tax (LTT) has remained a central issue in Toronto politics since its inception in 2007 almost 5 years ago. The levy of a Toronto LTT imposed on the buyer of all residential and commercial properties added approximately 1.5% to the cost of the sale, nearly doubling the transaction costs required to close a real estate transaction. The Toronto LTT has been a contentious issue since the beginning. The political ramifications were felt both by the left leaning city council led by Mayor David Miller who originally implemented the tax, and since 2010, by the conservative populist lead municipal government of Rob Ford. The Toronto LTT, however, has proved to be a major revenue generator for the city due mainly to an extraordinarily buoyant real estate market that could reverse, leaving a deficit in the city's budget as quickly as the surpluses that it has come to count on in recent years. Also, now that the tax has been in effect for some time, research indicates that the Toronto LTT has adverse effects on regional household mobility and welfare and could be contributing to urban sprawl which could have a detrimental effect on Toronto's position as one of the creative capitals of North America.

This practice paper will first provide a brief history of provincial and municipal policies leading up to the implementation of the Toronto LTT. The effects on municipal politics as reported by the local media will then illustrate public sentiment of the tax throughout the past 5 years and the effect the Toronto LTT has had on stakeholders including homeowners, local businesses and the real estate industry. The Toronto LTT will then be compared to other forms of transaction based taxes in other cities and research will be explored on the effects of such taxes on mobility in Toronto and abroad. Finally, the Toronto LTT will be examined as it relates to mobility and its negative impact on creative cities.

Events Leading up to the Toronto Land Transfer Tax

Over the past two decades municipalities in Ontario have been chronically underfunded as services have been downloaded from the provincial and federal governments. As Mulvale, 2001 summarized:

> It is a brilliant strategy that has allowed both the federal and Ontario governments to balance their budgets and enjoy large surpluses. The same cannot be said for municipalities and the property taxpayer. Simply put, municipalities are at the bottom of the financial and constitutional food chain. What distinguishes local government from the other forms of government is its limited revenue source which is made up mostly of the property tax base and topped up with user fees. Unlike the federal and provincial governments, municipalities have a legal requirement not to run a deficit budget (Mulvale, 2001, para. 2).

This was especially true in Toronto where the city had the added financial burden of such services as housing for the homeless, and services for new immigrants, which both groups tended to gravitate to the City relieving adjoining municipalities on the fringe without the obligation. Transportation costs were also downloaded which forced Toronto to handle most of the financial burden even though those in the surrounding municipalities took advantage of both roads and public transportation to get to and from work and entertainment venues. The Supreme Court of Canada in a recent court case expressed it by saying “Municipal governments are creatures of the provincial governments. These institutions have no constitutional status or independent autonomy and the province has absolute and unfettered legal power to do with them as it will” (Bird and Slack and Tassonyi, 2012, p. 172). As the Province of Ontario downloaded services to the municipalities they did not ease up on the restrictions the province had on cities to collect revenues.

Most provincial governments in Canada curtail the ways that municipalities can collect revenue. Unlike some cities in the United States and Europe, municipalities in Ontario cannot collect income tax, impose taxes on the sales of services and goods or on hotel accommodation, or on any form of energy tax, whether it be solar panels, gas, or hydro. The then ruling Liberal government, in recognition of the extra burden Toronto faces in the region, allowed the city to impose certain revenue generating vehicles in 2006. The ‘City of Toronto Act’ now had a host of new taxes and levies at their disposal, including alcohol and tobacco taxes, entertainment taxes, vehicle registration taxes, billboard taxes, congestion taxes, parking taxes, road tolls and land transfer taxes” (Bird et al., 2012, p. 196). “Expenditures in the city of Toronto increased by almost 9% between 2006 and 2007. This increase resulted partly from the ‘downloading’ of provincially mandated programs and partly from a rapid and sustained increase in operating expenditures. The increase in expenditure was offset by a revenue increase of about 3%. The resulting budget shortfall was about half a billion dollars” (Dachis, Duranton and Turner, 2012, p 331). The City decided to impose its new power in the following year by implementing a municipal vehicle registration tax and the Toronto LTT.

Implication of the Tax on Toronto's Political Scene

The Toronto LTT has been an important catalyst in the political drama in Toronto politics for the better part of the last decade. Mayor David Miller who led an inner-city centric, left leaning, council first pushed the province of Ontario for new powers of taxation for Toronto which resulted in the 'City of Toronto Act (2006)' and choose the implementation of the Toronto LTT and a vehicle licensing tax as the first two revenue generating vehicles for Toronto implemented under the Act. The reason the Toronto LTT was such a popular option for the city due mainly to its ease of implementation (Griffiths, 2010). Ontario has been collecting about $1.1 billion dollars a year in provincial LTT (Aaron, 2007). A study by Dachis, Duranton and Turner (2008) concluded that the combined Ontario and Toronto LTT's gives Toronto the highest transaction costs in North America. City of Toronto staff reported at the time that the vehicle licensing tax of $60.00 per vehicle was expected to generate about $56 million per year in revenue and the Toronto LTT was budgeted to generate $300 million per year for the city (Kelly, 2007). The new municipal taxes narrowly passed a vote amidst overwhelming negative press and despite strong opposition by right – wing councillors. The media's support of the Toronto LTT was overwhelmingly negative at the time of the tax's implementation and during the remainder of Mayor David Millers time in office (Aaron, 2007; Mintz, 2007; Moloney, 2008).

Media reports continued to be negative toward the tax during the election campaign which began in the spring of 2010 and lasted until the election in October 2010 with many of the newspaper interviewers using the Toronto LTT as one of the first questions they posed to candidates during the campaign (Alcoba, 2010; Kuitenbrouwer, 2010; Wong, 2010). Media campaigns by stakeholders like the Toronto Real Estate Board (TREB) fueled the fire by released surveys by independent research companies such as Environics that "65 per cent of Torontonians want this tax repealed" (O'Neill, 2009, para. 3). It is interesting to note that during the mayoral campaign most of the other leading candidates were quoted as saying that the Toronto LTT was unfair and should be abolished or at least reduced (Alcoba, 2010). None of the other front runners, however, were willing to make it a campaign promise, citing that the revenue generated from the tax would have to be replaced from other sources. Most media sources during the election were clearly in favour of abolishing the Toronto LTT (Alcoba, 2010; Kuitenbrouwer, 2010; Wong, 2010).

Political backlash by voters in the city fringe area to what was considered outlandish spending and higher taxes, led to the replacement of Mayor Miller and many of his left oriented council by conservative leaning elected officials. The new council led by populist Mayor Rob Ford, won the election based on a campaigned to abolish much of what of the previous administration had accomplished including the Toronto LTT, branding it an unfair tax which taxed a few a disproportionately large amount.

It has become evident, during the first two years of the mayors term that there was actually not much from the budget that could be cut without also making cuts to services

(Alcoba, 2011; Church 2011; Gee 2011). The Mayor was able to fulfill one of his promises by trimming some costs by renegotiating city employee contracts, but in the 2012 budget broke a campaign promise by asking all departments to shave 10% from its expenditures, causing substantial cutbacks to services (Dale, Moloney and David, 2012). Ironically, the only unexpected additional revenue has come from surpluses from The Toronto LTT, the very tax the mayor campaigned feverishly to abolish.

Although media reports now range in tone from ambivalence to grudging supportive for the Toronto LTT due to its huge revenue stream, the tax still remains a topic regularly brought up but focus on Rob Fords plummeting popularity caused mainly from a lack of creditability due to politically damaging interactions and broken campaign promises (Dale et al., 2012). In 2012, the mayor's stance has changed to the degree that he hopes, if budgetary concerns allow, to reduce the Toronto LTT later in his term at office.

Effects of the Land Transfer Tax on the Economy

Now that the Toronto LTT has been in effect for almost 5 years, there are a number of studies on the effects of the tax on both the city of Toronto and the surrounding region. These studies show that the transaction based tax affects not only the local economy, but the welfare of citizens.

The Toronto LTT has been shown to reduce the price of homes in the city. In areas on the fringes of the city, areas which typically have lower than average home values Dachis et al., (2012) shows evidence that housing price have increased at a slower pace than the immediate surrounding areas just outside of the city boundaries not effected by the tax. The study measured the areas within 5 kilometers of the Toronto border and concluded “that the results of our price regressions suggest that the LTT led to a decrease in Toronto property prices of about the same magnitude as the tax” (p. 347). This translates to a reduction of about 1.5% given the average Toronto LTT paid in the city.

The Toronto LTT has been shown to reduce the amount of home transactions. By performing regression analysis on over 139,000 single-family home sales between January 2006 and August 2008 Dachus, et al. (2012) concluded that measured the effect of the Toronto LTT that there were 14% less sales in the Toronto region because of the tax. A net reduction in transaction can also be used to measure residential mobility which is discussed later in this paper.

The Toronto LTT has been shown to promote urban sprawl. Research by Song (2009) observes “a lower tax rate in the suburbs induces more outward development and thus more expansive and decentralized urban area” (p. 829). Decentralization, Song (2009) point out, “increases reliance on transportation systems which are expensive to build and maintain” (p.831). This is especially true in Toronto with its chronically under-funded transportation system and clogged highways (Hume, 2006).

The Toronto LTT has more impact on the poor than the rich. It’s been argued that the Toronto LTT only taxes the wealthy – those affluent enough to own a home or an investment property. It was reported by Kelly (2007) that the Toronto LTT will add $4,475 in closing costs to the purchase of the average priced home in the city. This is an upfront cost that adds approximately 1.5% to the cash required by a buyer on closing. In a study by Dachis et al. (2008)

it was estimated that the Toronto LTT had a greater negative affect on the number of transactions in less affluent areas of the city which experiencing drops of 30% compared to 9% in richer areas.

The recent Real Estate boom in the city has shown increases in prices in all areas of the city, poorer areas, however, are increasing at a slower rate than richer areas suggesting that the Toronto LTT is affecting those making an average income more so than those in the upper income levels. This indicates that the Toronto LTT is having a larger effect on buyers with lower incomes (Dachis, 2012).

The Toronto LTT has been shown to increase home prices in high income areas. Conversely, an article in the Toronto Star sited TREB statistics and concluded that the Toronto LTT was the main cause for the average cost of detached home escalating 17% from 2011 to 2012 to over $800,000, a level never reach before (Pigg, 2012). TREB attributed the increase to supply and demand caused by homeowners electing to hold on to their home due to the higher transaction costs instead of selling and buying a larger home. Although no academic studies have been found to support this claim on a city-wide scale, an analysis by Dachis (2012) tracked sales since before the implementation of the Toronto LTT until April 2012. Findings proved that the fringes of the city outside of the Toronto border reported building permit value increases per month at about half of what suburban boroughs inside Toronto reported. The analysis attributed this increase to the impact of the Toronto LTT on mobility. A homeowner electing to do renovations to their existing property instead of moving to an $800,000 home will avoid paying Toronto LTT of $11,725.00, combined with the Ontario LTT, the total saving are

$24,200.00. This represents a substantial amount of savings that a homeowner could put toward renovation costs but could compromise location decisions.

Land Transfer Tax - An Unfair form of Taxation

The reality is that that land transfer taxes levy a huge tax burden on the small minority of the population who choose to move. The 2012 mill rate for the City of Toronto for residential homes is 0.77% of the assessed value which is paid by all homeowners in 6 installments over the year. This means a purchaser of the average priced detached home in Toronto (approximately $800,000) pays $6,160.00 in property tax. As mentioned previously, a buyer pays over $24,000 in LTT, almost 4 times the annual property tax amount. This tax must pay it in one payment at the time of sale and the buyer receives no extra services in return. People need to move for a variety of reasons, families grow as children come in to the world and shrink as children grow up and go off to school or work. Divorce, job relocation, reduced ambulatory abilities of the elderly, lifestyle changes and commuter times can all be legitimate reasons for people to seek new housing and should not be penalized such an exorbitant tax simply for moving.

One of the arguments that policy makers used when the passed the Toronto LTT was that it would help to prevent speculation. Speculation represents a very small portion of all Real Estate transactions (Dachis, 2012). Also not all Real Estate speculators are bad. Many perform a valuable service to the community by increasing intensification and improving the quality of the housing stock. Taxes on the transition of land have had a detrimental effect on all speculation, good and bad, and are levied unevenly.

Prior to the introduction of the Toronto LTT there was a buoyant market for those speculators willing to take a substantial risk by purchasing a property near the end of its life cycle or in great need of repair. The speculator would then build a new home or sometimes two or three if the lot size permitted, or perform major renovation and then attempt to sell it at a profit. In addition, to the Ontario LTT, the speculator would be responsible for paying any capital gains taxes on the profit, however, smaller speculators can move in to the home and avoid paying capital gains if they claimed the property as their personal residence. In any case, most speculators in this market were highly creative. They require intimate knowledge of the local zoning requirements, construction skill and a good design sense. They also take a substantial risk due factors such as market corrections. Buyers of the finished product were usually those ill-equipped to complete a major renovation themselves and were willing to pay a top-dollar to purchase a home that had been completely renovated. This type of speculation has all but ended as the additional cost of the Toronto LTT has cut back substantially on profit margins. As one speculator, Peter Czumak, a builder who has constructed and renovated over 20 homes in Toronto, told me, “the margins were never more than 10% to 20% of my investment, I had to wait over a year in most cases before I realized any profit and sometimes I barely broke even. The Toronto LTT increased my costs to the point that it just wasn’t worth the risk anymore” (personal communication, November 15, 2012). Although it can be argued that this type of speculation contributed to higher real estate values and displacing residence of older neighbourhoods by escalating gentrification, it did help to renew the housing stock and increase intensification.

The most mercenary speculators in the real estate market, are those buying condominium units off plans, prior to construction, who then flip them to another buyer by assigning their agreement of purchase and sale prior to closing. They add no value to the community and often avoid paying capital gains and land transfer tax as the assignment is never registered with the land titles office and therefor no sale is recorded (Francis, 2012). Many of these Buyers are foreign citizens and the proceeds from their profit do not remain in Canada (Castaldo, 2012).

The development of a condominium, on the other hand, can be levied land transfer taxes a number of times during the development process. Adjoining lots are assembled by speculators who purchase from single family home owners and small businesses and apply to the city for site plan approval and rezoning. This usually involves relief from the municipalities zoning by-laws which usually including height and use restriction. Upon closing, a land transfer tax levy is triggered. Upon completion of the rezoning, the original speculator often enters in to a joint venture or sells out right to a developer who actually constructs the project, triggering yet another land transfer tax on the same property. Finally, after completion, the buyers of the individual units each pay land transfer tax on the purchase price.

An unpredictable form of taxation

You just have to count the cranes in downtown Toronto to know that the city has been experiencing a Real Estate boom. The Toronto LTT is expected to raise over $90 million dollars more for the city than originally budgeted in 2012. This is a huge surplus for the city coffers considering that high publicity contract negotiations with inside and outside workers and a recent TTC fare increase are only expected to bring in about $27 million (Church, 2012). Although this unexpected revenue may appear as a bonus, surpluses give councillors a false sense of security and are a sign of mismanagement. Difficult decisions are made to balance budgets at the beginning of the year. In 2012 the City of Toronto threatened to close Libraries and Pools as departments were asked to trim 10% off their budgets (Dale et al., 2012). Many of the cuts could have been avoided if the City was aware of the additional win fall from the Toronto LTT. A more predictable revenue stream means municipalities can collect the amount of taxes required to fund the city's expenditures nothing less, nothing more.

The unpredictability of the revenue generated from LTT can create a deficit just as quickly as a surplus. Transaction based taxes fluctuate based on the number of sales within the municipality which make revenue unstable. Data provided by TREB (2012) illustrate that the number of sales are much more erratic year over year than average sale prices for the same period (Graph A and B). In a changing Real Estate market, the number of sales plummet well before the average sale price goes down.

Graph A

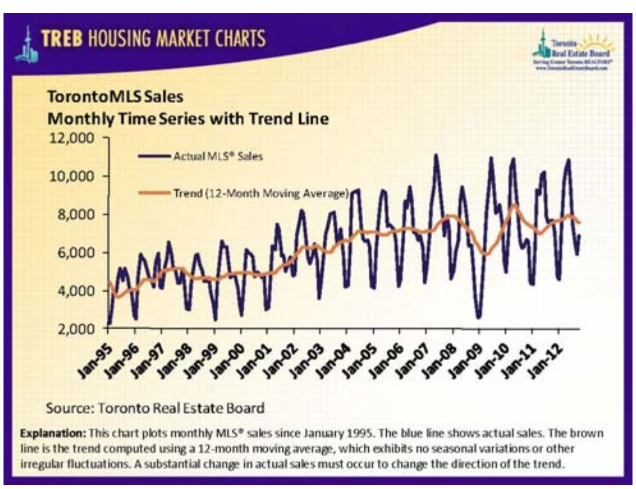
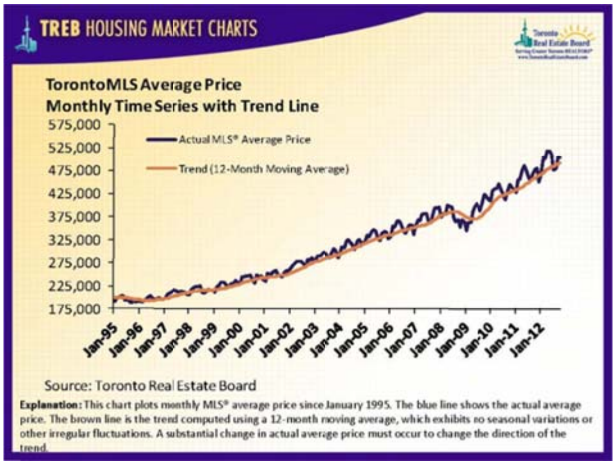


Chart B



Sellers decide to hold on as opposed to taking less for their property than what they feel it is worth. Markets can change quickly as was the case in 2008 when the financial crisis shocked economies throughout the globe. In the United States prices decreased 30% to 40% in some areas such as Phoenix and Las Vegas (Florida, 2010). Canada survived the crisis better than most countries due to our strong banking system, however, Graphs A and B illustrate the number of sales slid over 25% and the average sale price dropped during the same period by about 5% in the months following the 2008 financial crash. Land transfer taxes are unlike property taxes which are a more stable form of taxation since property taxes can be adjusted to match desired revenue by regulating the mill rate (Dachis, 2012).

The Effects of Land Transfer Tax on Mobility

Studies in other areas of the world have used regression analyse to understand the effect of land transfer taxes on mobility. Below are details from 2 studies in Europe.

- Amsterdam Study

A study in Amsterdam measured the marginal effects of transaction costs on residential mobility (Van Ommeren and Van Leavensteijn, 2005). In the Netherlands, transaction costs are typically about 12 percent of the property value which include a 6 percent buyer tax (LTT) as well as brokerage fees. In North America, brokerage fees are usually paid by the Seller. The combination of LTT and brokerage fees make transaction costs in the Netherlands the highest in the world (Van Ommeren and Van Leavensteijn, 2005). Total transaction costs represents about 50% of the average net annual income in the Netherlands, the land transfer tax alone is equal to about 25% of the countries net annual income. The analysis concludes that residential mobility is reduced by 8% by every 1% in transaction costs and that other forms of revenue generation would be less costly on the local economy.

- London Study

The United Kingdom has had a form of Land Transfer Tax since the 1950's. The current system, called the Stamp Duty Land Transfer Tax (SDLT) has been in operation since 2003 and imposes tax of between 1% and 5% on the sale of homes over £125,000.00. A home of £250,000 would be levied a SDLT of 3%, typical to that of a home in Toronto with the combined Ontario LTT and Toronto LTT. The study by Hilber and Lyytikäinen (2012) found that the stamp duty had a detrimental effect on the economy. The study found that "a 2% increase in SBLT resulted in a 40% decrease in mobility and further analysed the impact on the tax on both short and long distance moves and found that the tax affected short distance moves the most" (p. 16). The study went on to say that "short-distance moves are typically related to adjustments in housing consumption. This implies that the stamp duty leads to a misallocation of dwellings in the housing market" (p.16).

One of the most extensive studies on the effects of Land Transfer Tax on mobility was conducted by Dachis, et al. (2012) in Toronto who, as you can tell, has done extensive research on the Toronto LTT.

- Toronto Study

Dachis, et al. (2012) were able to analyse data from the sale of almost 140,000 homes in the Toronto area for the time period before and after the passing of the Toronto LTT. This gave a unique opportunity to measure the impact of the tax with few other mitigating factors. Their study concluded that the Toronto Land Transfer Tax caused a reduction in home sales of approximately 3,000 per year in Toronto which translated to an average 14% decrease in residential mobility for homeowners. In addition, their study calculated the welfare loss associated with Toronto's LTT. "This welfare loss, effectively the cost of foregone mobility, is substantial, about $1 for every $8 in tax revenue raised or about $19 million per year for Toronto" (Dachis et al., 2012, p. 351).

Alternative Revenue Sourcse to the Land Transfer Tax.

As a study by Dachis et al. (2008) pointed out, "other forms of revenue generation such as an increase in Property Tax or a municipal sales tax on goods and services, would evenly distributed the tax burden to all citizens in the city" (p. 3 - 5).

The popularity of LTT's around the world has been attributed to their administrative convenience (Bird and Slack 2004). This is confirmed by a City of Toronto Auditors by Griffiths (2010) which report that stated:

> In order to manage and collect the new Municipal Land Transfer Tax in the most cost effective manner, the City entered into a 10-year agreement with Teranet. Teranet is a private company that runs the Provincial electronic land registry system. Teranet has been managing the administration and collection of Provincial land transfer tax since 1999. Consequently, the infrastructure in relation to the administration of the City's land transfer tax was already in place and, as such, there was no need to design or implement a new management information system in relation to the new tax. (p. 1)

The simplest and fairest way to raise revenue would have been to increase the property tax by a small amount (Dachis et al., 2008). This, however, has shown to be unpopular politically in many municipalities as homeowners adamantly resist any increases to property taxes and are more accepting of imposing a tax on those actually buying and selling properties. Still, Property Tax is considered to be a fair local tax (Bird, et al., 2012). "It is a well-established tax that yields substantial revenues. The tax base is immobile and easily accessible to and verifiable by local authorities" (p. 198). In addition, "In contrast to land transfer taxes, an ordinary property tax has no impact on mobility" (Dachis.2012, p. 16).

Property taxes are highly visible taxes, that unlike sales tax and income taxes require homeowners to sit down and write out large cheques to the municipality. The services, that you get from Property Taxes, however, are also highly visible - Road, libraries, police, schools and snow removal are all expenditures that result from the collection of Property Taxes and are all shared by the community at large. Property taxes make up almost 50% of municipal revenues (Bird and Slack, 2004) and all property owners pay on a proportionate basis, based on value.

There are some issues with the Property Tax system, however. In Toronto, gentrification can lead to a rise in property value that cause long time residence to pay higher proportionate taxes than they would have if the area had remained the same. Also, the City of Toronto mill rate for commercial properties mean businesses would pay a significant higher property tax than those in adjoining outer municipalities. The City has responded to these inequities in the property tax structure by limiting annual increases by phasing them in over a few years.   The point is, that property taxes can be tweaked to make the tax equitable.

Toronto LTT and The Creative Class

One of the central tenants of Creative Class theory is 'quality of place' and the new role of cities in today's economy. This creates even more incentive for cities to do all they can promote their position in the new economy. As Richard Florida (2012) states in The *Rise of the Creative Class – Revisited,*

> Place has replaced the industrial corporation as the key economic and social organizing unit of our time. Cities have always been important engines of economic growth, but they are assuming an even greater importance in today's knowledge-driven innovation economy, in which place-based ecosystems are critical to economic growth. (p. 280)

Cities as now economic drivers and municipalities need to attract and create businesses and workers and retain them once they are here. The creative class have skill sets that will allow them to work in any location and onerous transaction costs associated with moving may result in Toronto residence considering other municipalities. Cities must remain competitive in order to increase or even maintain their position in the global economy. One of the best ways of doing this is to ensure that companies can relocate to where skilled employees live and that workers can move to new homes with easier access to work places. As Florida (2010) points out "in today's economy and the economy of the future, geographic mobility is required to match workers and their skills to appropriate jobs".

The importance of employee mobility has also been studied as it relates to technology innovation. Kerr (2010) demonstrates:

> that development of breakthrough technologies tend to be followed by subsequent intensive research and development that refines the initial innovation. This process attracts additional scientists and engineers to the location where the breakthrough occurs, and contributes to movement of innovative activity across cities. The speed with which such adjustments occur depends in part on the mobility of technical workers. (p. 47)

This can work both ways. In Toronto, companies are now moving to where creative workers live. The downtown areas and neighbourhoods close to major public transit routes have higher human capital than areas in the periphery of the city (Hulchanski, 2007). Employers such as Telus, Deloitte, TELUS, Coca Cola, SNC Lavelin and most recently Google have relocated office in the city core. The vacancy rate for office space downtown now sits at 4.3% down from 5% a year ago while availability rates have risen from 8.2% to 8.9% in the suburban areas over the same period (Cushman and Wakefield, 2012). This movement from the suburbs to the core is expected to continue as many workers contemplate moving due to the availability of new housing stock near the core caused by the condo boom (Perkins, 2012).

Although most companies lease space, some have decided that purchasing makes strong economic sense. SAS Canada, for instance, recently built a new 110,000 square foot office building (Restivo, 2004). Municipalities that levy transaction based taxes hinder the ability of companies to react to varying market conditions and relocate where employees live. Also, as companies relocate the effects of the Toronto LTT on residential mobility restrict homeowners from moving to locations that offer easier transportation and better lifestyle. As Kerr (2010) found in his research "Cities that allow workers to be highly mobile will be more attractive to the creative class. The underlying mobility of the workforce also appears quite important for the speed at which spatial adjustments occur". (p. 17)

Increased residential mobility is an important factor in retaining employees. Young people, especially those in their 20's that are highly educated are the most mobile (Florida 2012). Attracting them to a city at the beginning of their occupational life and retaining them throughout the cycles of their life is essential for cities if they want to remain competitive. Those who decide to come to Toronto for school often decide to stay in the city to work. As those employees settle down, find life partners, divorce, and possible have children their housing requirements change.

The Toronto land transfer tax is hurting Toronto. The tax has had a derisive effect on city politics, is unfair for the few who have to pay it and is contributing to urban sprawl which in turn is putting even more pressure on an already strained municipal infrastructure. The tax also acts as a disincentive to residential mobility which could affect Toronto's global competitiveness. The Toronto LTT should be abolished and other forms of revenue generation should be investigated by policy makers such as an increase in property tax.

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