This Rose, By Any Name, Stinks

Property taxes are just a badly designed income tax and should just be replaced with a better one

Juanita Spencer

November 2012
Atlantic Institute for Market Studies

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Juanita Spencer, a Halifax based policy researcher, is AIMS’ Manager of Research & Operations. She has an extensive background in helping individuals and small businesses navigate the government labyrinth. An entrepreneur herself, Spencer also spent time with the Canadian Federation of Independent Business and the Metropolitan Halifax Chamber of Commerce. Her policy research and member service roles gave her exceptional insight into how business responds to government activities.

Her Master’s level research focused on correcting the unintended consequences of well-intended public policy. She has written on the perverse incentives built into university funding and provincial transfers, the taxation and regulation of small business, and the challenges around getting public consultation and engagement right in the modern era of direct electronic interaction and immediate feedback.

Spencer has delivered talks to future policy leaders on the small business-government interface, and has had numerous leadership roles in organizations bridging the gap between government and community, including Co-Chair of her local School Advisory Council, Board member at Canada Nova Scotia Business.

Spencer has a BA from Saint Mary's University and an MPA from Dalhousie University. She lives in Halifax with her husband and three young children.
Criticisms of the property tax system are routine and growing. This paper will make the case that those criticisms are well founded, not because tying taxation and consumption together (in order to limit both) is not a good idea, but because property taxation is simply income taxation in disguise. A badly designed, regressive, and not appropriate to modern realities disguise at that. It would be far better to simply tax income directly as opposed to by stealth, and balance that taxation with user fees where those fees are appropriate.

For Nova Scotia, the system of property taxation and assessment dates back to the 1880s. With the property tax system so generally and roundly condemned, the consideration of alternatives obviously becomes necessary.

The two alternatives that are most commonly contrasted to the property tax are taxes on consumption or income. We could also consider simply adjusting the property tax, or building a hybrid model that in some way blends property/consumption and income taxes. In the HRM, we already have a blended tax base based on user fees (consumption taxes), property taxes and indirect income taxes in the form of transfers from other levels of government.

This paper considers the proposition of a municipal income tax in light of national and international experiences and by applying Adam Smith’s four maxims on taxation: Equity, Certainty, Convenience and Efficiency.

The author finds that national, international and local experience clearly demonstrates that the connection between property values and ability to pay is tenuous at best. To adhere best to the maxims of effective taxation, municipalities should move to a blend of consumption and income taxes. Consumption taxes should be used wherever possible to deliver “luxury” services but also to act as a brake on free riding and rent seeking, where organized interests seek to secure a benefit for themselves at the expense of others.

Finally, income taxes should replace property taxes as the principal source of local revenue. Income taxes are simpler to administer, involve less local enforcement effort, are convenient for the tax payer and, provided they are simple and predictable, income taxes are more equitable than property taxes. While competition on rates is to be expected, even encouraged, this transition from property to income taxes should occur on a province wide basis to ensure maximum comparability for taxpayers and maximum administrative efficiency and cost containment by government.
Introduction

In its annual alternative provincial budget for 2012, the Nova Scotia office of the Canadian Centre for Policy Alternatives (CCPA) includes “Municipal Income Tax: A Progressive Alternative to Property Taxes (CCPA, 2012, p. 27) It argues for a Refunded Municipal Income Tax, or REMIT, which would be a surtax placed on your provincial income taxes and could, they argue, eventually wholly replace the outdated property tax.

The CCPA is not alone in advocating for this type of shift. The Nova Scotia Chamber of Commerce released a report in October 2012 calling for the elimination of property taxation and a shift to some form of income or consumption taxation, or a mix of the two (NSCC, 2012). Mayor Naheed Nenshi of Calgary has suggested it for that city (Mayor seeking public input…, 2010). It has similarly been suggested for Toronto (Weese, 2010) and for Ottawa-Carleton (Cullen, 2010) and many American cities already use income taxes as part of their revenue mix (About.com, 2010). Both Enid Slack and Harry Kitchen have considered the potential of a municipal income tax in the context of Canadian cities’ ongoing financial challenges (Slack, 2004; Kitchen, 2004).

According to the CCPA, “A major problem with municipal finance is the reliance on the property tax, which is expensive to administer and regressive, bearing more heavily on people with low incomes.” (CCPA, 2012, p. 27)

The CCPA is similarly not the first to espouse a critical view of property taxes (see for example academics like Enid Slack (2011), and commentators like Ryan Richmond (2009)). The June 2009 report to Council by the Halifax Regional Municipality’s (HRM) own Tax Reform Committee was equally damning:

...the (property tax) system seems to have less and less credibility. Citizens see the system as being unfair, overly complex and unaccountable. Tax increases seem to occur without a clear process or explanation. Individuals are frustrated by their inability to understand or to plan for tax increases... From our consultations with the public, it is clear that taxpayers are frustrated and feel that basic reforms of the tax system are required. Whether at public meetings or in public opinion surveys people consistently said they wanted reform of the tax system... The reasons for this dissatisfaction are many and complex. Citizens are looking to ensure they get value for their tax dollar. As such, they find it difficult to see the link between the available municipal services, how much they can afford and the taxes they are required to pay. (HRM,2009a, p. 4)

With the property tax so generally and roundly condemned, the consideration of alternatives obviously becomes necessary. The two alternatives that are most commonly contrasted to the property tax are taxes on consumption or income (see for example Carl Shoup, 1983). Of course, one could also consider simply adjusting the property tax, or building a hybrid model that in some way blends property/consumption and income taxes. Indeed, in HRM, we already have a blended tax base based on
user fees (consumption taxes), property taxes and indirect income taxes in the form of transfers from other levels of government\(^1\).

This paper will consider the proposition of a municipal income tax, but will do so in the light of national and international experience and by applying Adam Smith’s four maxims on taxation: Equity, Certainty, Convenience and Efficiency.

\(^1\) For that matter, economists generally agree that the majority of corporate taxes actually end up being a tax on wages or consumption. That is the ‘corporation’ pays nothing, nor do its ‘shareholders’. The tax is paid by workers in the form of lower wages or consumers through higher prices. For a good discussion of this see Desai, Foley & Hines, 2007. This suggests that a high reliance on business property taxes, as in HRM, is actually an indirect way to shift local tax revenue to consumption and income taxes.
Assessing the potential for a Municipal Income Tax in HRM

It is perhaps not surprising that criticisms of the property tax system are routine and growing. For Nova Scotia, the system of property taxation and assessment dates back to the 1880s (HRM, 2009a, p. 3). While refinements in property valuation have been achieved and changes have been made in what is included as assessed property, the basic model and the underlying assumptions remain the same. The government assesses and values the property you own then determines your fair share of the needed local tax revenue on the assumption that the value of what you own is a good proxy of your ability to pay that share. Most now agree this connection between property value (or wealth) and income (or ability to pay), is transitory at best. Indeed this disconnect was both the driving force behind the recommendations of the HRM Tax Review Committee (HRM, 2009a, p. 9) and the opposition to its property based reform proposals (Bousquet, 2009).

In an age where property valuation is generally tied to market value and market value is driven by the capacity of everyone, not just the home owner, to consume, it is not uncommon for the value of a home to far outstrip the income or “ability to pay” of the homeowner. HRM has put in place various mechanisms to protect the ‘lonely widow on a fixed income’ from losing her home because ‘land speculators’ and ‘come-from-away’ absentee land owners or casual residents drive up her market assessment. HRM offers assistance in meeting their tax obligations to families with under $29,000 in income: they offer rebates up to $850 per year, and they also can supply more permanent tax deferral of taxes owing through a lien on the property that is collected when the home is sold (HRM, 2009b, p. 10).

The clear disconnect between home value and ability to pay can be seen visually in the chart below. The chart compares the growth in average home value versus the growth in average annual income over the ten year period between 1996 and 2006. Average house values rose at almost double the pace of average incomes in HRM.

![Chart showing % change in home value and income](chart.png)

Source N.S. Community Counts, 2012a&b

More recent data suggests this trend may be leveling off. With Statistics Canada reporting that new house pricing index rose only 12% in the period 2007 to 2011, while figures on median total income by family type indicate that it rose 16% between 2005 and 2009 (Statistics Canada, 2012a; Statistics Canada 2011a). Nevertheless, it is very clear that there is a gap between property value and ability to pay as represented by a person’s income.
Using census data, the HRM Tax Reform Committee actually ran a regression analysis testing for correlation between these two factors. Their findings mirrored the results presented above. There is no obvious correlation between property value and ability to pay. Specifically, in comparing household income and home value as reported in the 2001 and 2006 census they said:

_A Regression Analysis was run on the data and a Correlation Coefficient and a Coefficient of Determination or r-squared was calculated. A r-squared is expressed as a number between 0% and 100%. Zero shows no correlation while 100% shows a perfect correlation. In the case of the 2001 census data the value of a weighted analysis of table occurrences showed only a 27% r-squared. This shows that the value of one’s home is not a good predictor of one’s income. In other words, there is not a significant relationship between income and home value. Staff repeated this test when the 2006 census was released. The r-squared using the 2006 data showed a consistent although slightly weaker relationship. Statistically, the r-squared value of a weighted analysis of table occurrences for 2006 showed only a 22% predictive value of home value (in determining income). (HRM, 2009a, p. 9)_

The Committee then went further in their analysis and considered the implications of the provincial cap on residential property assessment. This cap does not allow the assessed value of a residential property to grow faster than the provincial rate of inflation. While the market value of a property may rise faster than inflation, for tax purposes, any rise above inflation can only be taxed after a property has been sold. This protects the current owner from sudden rises in assessment, but ensures that future buyers, who presumably have a greater ability to pay because they have absorbed the higher sticker price, are subject to taxation at the then market value. According to the Committee, this effort to both have our cake and eat it too actually further undermines what little connection between income and house value they were able to find. In their words:

_Neither the 2001 nor the 2006 census data take into account the changes made to the Provincial Assessment Cap, which limits assessment growth to the Consumer Price Index. The introduction of this program (which is not income tested) will likely make the relationship between income and home value even less reliable. (HRM, 2009a, p. 9)_

This HRM specific conclusion is supported by the similar criticisms included in the province wide critique of the provincial assessment cap which was published by the Union of Nova Scotia Municipalities (UNSM). They too highlighted the disconnect between assessment and ability to pay and the distortionary impact the assessment cap was having on the equitable distribution of the tax burden (UNSM, 2011).
This obvious disconnect between property value and income is a clear violation of the first maxim of effective taxation: Equity. The four maxims for effective taxation (the others being: Certainty, Convenience and Efficiency) were first laid down by Adam Smith in 1776 in his seminal work, “An Inquiry into the Nature and Causes of the Wealth of Nations” (Smith, 2000). The maxims were as follows:

I. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.

II. The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person.

III. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it.

IV. Every tax ought to be contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.

(Smith, 2000, p. 888-889)

The findings of HRM’s Tax Reform Committee, the arguments of the CCPA, and the opinions expressed by the public, strongly suggest that property taxes violate not only the first maxim, Equity, but also the second, Clarity. It is generally agreed that there is not only a disconnect between property value and income/ability to pay, but also between property value/assessment and the eventual tax bill, as well as between the tax bill and the services received in return for the taxes paid.

As to the final two maxims, the use of mortgage payments as a common means to collect property taxes owing certainly puts property taxes firmly in line with the maxim of Convenience. As a property owner, the author can attest to the fact that the payment of property taxes is so convenient that the tax bill is largely forgotten except for the days immediately following its receipt in the mail.

As to maxim four, Efficiency, property taxes again run afool of Smith’s ideal. Smith described this maxim in greater detail and suggested that a “tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury”, in the four following ways: 1) it could give rise to excessive administrative costs, 2) it may discourage growth in the tax base, 3) it could
encourage excessive tax avoidance and finally 4) it could subject taxpayers to unacceptable levels of administrative grief or intrusion (Smith, 2000, p.889).

The CCPA cites HRM’s annual bill for property assessment as $6 million per year (CCPA, 2012, page 27). The elimination of the property tax in favour of an income tax would reduce the “overage” of the state by that figure. The Tax Reform Committee highlighted meanwhile that “the current tax system does not support the Regional Plan. Efficient forms of housing such as multi-unit properties are very cost effective for a municipality to service. In the case of condos, however, they are taxed nearly as high as homes. Apartments have lower taxes but this is changing as the assessment cap shifts more of the tax burden onto apartment buildings.” (HRM, 2009a, p. 5) Finally, the public opinion collected by the Tax Reform Committee clearly indicates a level of frustration with the complex and vexing property tax process (HRM, 2009a, p. 4).

The fact that the modern property tax, at least as it is practiced in HRM, so obviously violates the core maxims of Smith’s ideal tax system is actually quite surprising. This is because Smith himself was a proponent of consumption and property taxes, over taxes on labour (i.e. income taxes):

"In all cases, a direct tax upon the wages of labour must, in the long run, occasion both a greater reduction in the rent of land, and a greater rise in the price of manufactured goods, than would have followed from a proper assessment of a sum equal to the produce of the tax, [levied] partly upon the rent of land, and partly upon consumable commodities." (Smith, 2000, p.933).

We must recall however, that Smith was writing at a time when property was indeed an almost direct proxy for wealth and ability to pay and when taxes on labour would largely have only fallen on the comparatively poor. In those circumstances, the application of his maxims would obviously have led to the conclusion that a tax on property was the most appropriate option – being more equitable, simple, convenient and efficient. As we have seen, however, the connection between property and wealth has now largely been turned on its head, which might explain the popularity of the income tax with local governments around the world.
In terms of the trends in municipal revenue generation, and the striking nature of HRM as an outlier from these trends, the HRM Tax Reform Committee noted the following:

The Halifax Regional Municipality (HRM) has become overly dependent on property assessments. In the United States roughly 25% of Municipal revenue is from assessment-based systems. Across Canada about 40% of total revenue comes from such systems. In Halifax nearly 80% of revenues are from property assessments. Other Canadian cities have made reforms to their tax system. Many cities now make use of user fees and utilities for services, making them more service based than Halifax. Edmonton and Ottawa have both recently reformed parts of their tax system. In Nova Scotia some municipalities use dwelling unit fees to recover garbage costs or as a minimum tax. (HRM, 2009a, p.5)

Like the CCPA, and the HRM Tax Reform Committee, Kitchen and Slack when considering revenue options for local government, highlight the global trend towards a greater use of income taxes than is the case in Canada (CCPA, 2012, page 27; HRM, n.d.; Kitchen & Slack, 2003, p. 2228). Slack, in a 2006 paper for the Munk Centre in Toronto provides an updated breakdown of local taxation trends around the globe:

### Table 3: Distribution of Local Tax Revenues by Type of Tax in Selected OECD Countries, 2002 (%)

<table>
<thead>
<tr>
<th>Countries</th>
<th>Income</th>
<th>Property</th>
<th>Sales General taxes</th>
<th>Sales Specific goods and services</th>
<th>Taxes on use etc.</th>
<th>Total Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal</td>
<td>90.5</td>
<td>10.3</td>
<td>10.0</td>
<td>1.7</td>
<td>7.2</td>
<td>25.1</td>
</tr>
<tr>
<td>Austria</td>
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<tr>
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<tr>
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<td>1.7</td>
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<td>25.1</td>
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<td>90.5</td>
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<td>10.0</td>
<td>1.7</td>
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<tr>
<td>United States</td>
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<td>10.0</td>
<td>1.7</td>
<td>7.2</td>
<td>25.1</td>
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<tr>
<td>Other</td>
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<td>10.3</td>
<td>10.0</td>
<td>1.7</td>
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<td>10.0</td>
<td>1.7</td>
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<td>France</td>
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<td>Germany</td>
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<tr>
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<td>25.1</td>
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<td>7.2</td>
<td>25.1</td>
</tr>
</tbody>
</table>

Notes:
1. Income taxes include individual and corporate income taxes.
2. Property taxes include taxes on property including recurring taxes on net wealth.
3. Sales taxes include VAT, sales tax and other general taxes on goods and services.
4. Specific sales taxes on goods and services include special taxes on goods and services that are not taxed under a general sales tax (e.g. fuel, hotel, and motor taxes).
5. Taxes on use include taxes levied on the use of goods or services to use goods and not the goods themselves (e.g. poll taxes).
6. Other taxes include taxes on net wealth, taxes of death, and individual taxes mainly on business.
Slack and Kitchen argue that income taxes make sense, particularly for large metropolitan areas because: “local governments are increasingly being called upon to address issues of poverty, crime, regional transportation, and other region-wide needs. The property tax alone cannot provide sufficient funds for these growing expenditure needs.” They also suggest that “to the extent that local governments are required to provide social services” an income tax is the correct tax to use because income is more “closely related to ability to pay” (Kitchen & Slack, 2003, p. 2235). This finding mirrors the view of both the CCPA and HRM’s Tax Reform Committee.

Slack and Kitchen also emphasize that Canadian municipalities themselves have, historically been the primary collectors of income taxes, it is only in the post-war era that the local nature of income taxes was traded for a more federal approach:

Canadian municipalities are not without experience in levying income taxes. More than 80 years before the imposition of the federal income tax in 1917, both provincial and municipal governments levied a tax on income. Indeed, municipal income tax revenues then exceeded provincial income tax revenues in every year up to and including 1930. By the end of the 1930s, every province in Canada had accepted some form of municipal income tax, although the rates and structure varied. A significant change came in 1941 when the provinces entered into the wartime tax rental agreement with the federal government, temporarily surrendering their right and the right of their municipalities to levy income taxes. Since that time, no municipality in Canada has been able to levy an income tax.

(Kitchen & Slack, 2003, p. 2234-2235)

Arguably, this shift to a national income tax from a local income tax violates at least two of Smith’s maxims of taxation; that of certainty and efficiency. As the taxing authority is moved to a greater distance from those paying the tax the accountability between those being taxed and those collecting the tax gets weakened. As a result, the capacity of special interests to “rent-seek” (pass the burden of their enhanced services onto others who have little or no say in the matter) is enhanced and the tax burden becomes less and less certain. Additionally, other special interests will then demand special exemptions from these ever higher taxes, ostensibly to protect or encourage desired activities or outcomes. As a result, the administration of the tax becomes ever more complex. These challenges underlie an extensive literature that targets the advent of national income taxes as the foundation of “big-government” and the waste and inefficiency that has resulted (see for example Chodorov, 1954).

In this sense, a return to local municipal income taxes (to the extent that it was matched with reductions in inter-governmental transfers, reductions in taxes levied by other levels of government, and greater certainty about the service delivery roles of each level of government) would actually be a means to begin reigning in the excesses of big government. It would be a tool for both the ‘right’ (to ensure that government focused on identified need and reduced waste and inefficiency) and the’ left’ (ensuring adequate resources were available to respond to those identified local needs).
Before we accept a local income tax as the solution to all of the world’s ills, let’s return once again to Adam Smith. Smith was, as mentioned earlier, a proponent of property and consumption taxes, not income taxes. He argued income taxes were the most disruptive to natural economic activity. They reduced the incentive to work, earn and invest.

He felt consumption taxes, particularly consumption taxes on luxury goods made sense in that “taxes upon luxuries are finally paid by the consumers of the commodities taxed, without any retribution" (p. 941), in essence no one is ‘obliged’ to contribute to the tax except those who have the ability and desire to do so. He also pointed out that “taxes upon luxuries have no tendency to raise the price of any other commodities except that of the commodities taxed” (Smith, 2000, p.941). In essence, the argument is that taxing consumption has the least effect on overall economic activity because people are just as likely to work and earn and invest whether a consumption tax is 2 or 5 percent (real world evidence of this theory abounds, one good example being Michael Smart’s (2007) analysis of the impacts of the Harmonized Sales Tax in Atlantic Canada).

Most deserving of praise by Smith was the “tax on ground-rents” or, the property tax. In Smith’s view property taxes “are a species of revenue which the owner, in many cases, enjoys without any care or attention of his own. The annual produce of the land and labour of the society, the real wealth and revenue of the great body of the people, might be the same after such a tax as before. Ground-rents, and the ordinary rent of land are, therefore, perhaps the species of revenue which can best bear to have a peculiar tax imposed upon them” (Smith, 2000, p. 909). In Smith’s time, all wealth and economic activity sprouted from property; taxing income or investment or trade, simply was taxing property indirectly and at greater cost. The cartoon below exemplifies this type of philosophy.
Assessing the potential for a Municipal Income Tax in HRM

Where property was the ‘trunk’ of all economic activity, then taxing property was the ideal approach under the four maxims. However, in an electronic age, where income and assets are more digital than tangible, does this analysis still hold? Where income is largely disconnected from wealth, and where real property values can be shown to have limited connectivity to the ability to pay of the majority of taxpayers, is property truly the appropriate metric for assessing an individual’s fair share of taxes? In the ‘knowledge economy’ does our capacity to learn and earn not become the ‘trunk’ of the global economy?3

3 This focus on people, not property, arguably lies at the heart of much modern thinking around the rise of cities. Richard Florida and his “creative class” being the most prominent example (Florida, 2002).
## The Three Tax Options Assessed Against Smith’s Maxims

<table>
<thead>
<tr>
<th>Maxim</th>
<th>Local Property Tax</th>
<th>Local Consumption Tax (user fee)</th>
<th>Local Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>No modern correlation between property value and ability to pay</td>
<td>Adheres to Smith’s maxim if focused on “luxuries”. Broad based consumption taxes can be made more equitable through low income rebates</td>
<td>Income is directly linked to ability to pay</td>
</tr>
<tr>
<td>Certainty</td>
<td>Subject to significant annual swings with no obvious correlation to owner value or services received</td>
<td>Provided tax is not hidden and rate is stable</td>
<td>As long as rate is stable and known</td>
</tr>
<tr>
<td>Convenience</td>
<td>Generally drawn down as part of other payments (rent and mortgage)</td>
<td>Paid at point of sale</td>
<td>Easily linked to existing payroll source deductions</td>
</tr>
<tr>
<td>Efficiency</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1) Administrative cost</td>
<td>Market value assessment and assessment appeals are costly in both time and money</td>
<td>Involves some administrative and collection costs, especially where there are multiple fees or taxes to support various services</td>
<td>Limited additional cost after preliminary adjustments are made</td>
</tr>
<tr>
<td>2) Drag on growth</td>
<td>Discourages property enhancement and equity investment</td>
<td>Generally considered the least limiting tax on economic activity</td>
<td>Rate must be carefully balanced against total tax burden to avoid disincentive to work</td>
</tr>
<tr>
<td>3) Promote avoidance</td>
<td>Encourages movement outside of desired areas to avoid higher rates or “in demand” areas</td>
<td>Those who wish to and can consume will. Overall impact on price remains important consideration</td>
<td>Competitive rate and total tax burden is key</td>
</tr>
<tr>
<td>4) Intrusive enforcement</td>
<td>Involves inspections, tracking of purchases and permits, assessment of usage</td>
<td>Limited intrusive enforcement except where violations are suspected and investigated</td>
<td>Involves no additional personal reporting than already held by government</td>
</tr>
</tbody>
</table>
We have already dealt with the much closer relation between income and ability to pay in modern times than the link between property valuation and ability to pay. Consumption levels, particularly of non-luxury items, tend to indicate need as opposed to ability to pay. Furthermore, the definition of “luxury” is a difficult one to assess and may involve a great deal of subjective interpretation. Is a computer, for example, now a luxury or a necessity? Does the same apply to a smart phone, or a tablet? On this first Maxim it seems an income tax would be preferable.

From a certainty perspective, a fixed percentage rate on your earned income is clear, predictable and not subject to large swings in value not associated with the direct actions of the individual being taxed. Land speculators might drive up the assessed value of your property, but only you and your employer can increase your income. You might not be aware of the first until after it has occurred, but you will be immediately cognizant of the latter. At the same time, consumption taxes, provided they are stable and not hidden, provide a similar level of certainty. On this maxim, a municipal income tax is at least on par with a consumption tax and well ahead of a property tax.

In terms of convenience, there is little to choose between the three methods of taxation in that the chief burden of tax collection falls largely on intermediaries and not the taxpayer. Property taxes are usually collected along with rents and mortgage payments, consumption taxes are collected by the vendor and income taxes by the employer. From the perspective of the taxpayer, little direct difference is readily apparent in terms of the convenience of any of these three transactions. Each occurs along with another, largely necessary and unavoidable, activity.

This relative comparability is also present in several of the underlining factors related to tax efficiency. Too high a rate of any tax; consumption, income or property, can encourage wasteful avoidance activities. However, consumption taxes are generally accepted to be the least disruptive to overall levels of economic activity. That said, the income tax because of its simplicity, ease of definition and enforcement would appear to have the edge on constraining administrative costs and limiting intrusive enforcement.

This admittedly qualitative analysis suggests that the global trend towards greater reliance on a blend of income and consumption taxes is well founded in the theoretical literature around taxation and, in turn, that the core concepts on appropriate taxation first laid down by Smith are still supported by the evidence available in the real world. To paraphrase Smith himself, “the evident justice and utility of (these) maxims (continue) to recommended them more or less to the attention of all nations” (Smith, 2000, p. 890).
How a Municipal Income Tax Could Work

In the global context, local income taxes are generally piggybacked onto existing state or national taxes. According to Slack and Kitchen, this is usually done in one of two ways. “The tax could be applied, as it is in the Nordic countries, at a locally determined flat rate on the same tax base as the national income tax and collected by the central government. Alternatively, the locally determined tax rate could be set as a percentage of the national tax liability, as in Belgium, or of the provincial tax liability, as in Switzerland and some US states.” (Kitchen & Slack, 2003, p. 2235)

A US study that looked at the implications of income taxes in Michigan cities found that smaller hub cities, as opposed to large urban centres, tended to fair better using income as opposed to property taxes. This was especially the case in cities that were home to major educational institutions, which tend to deliver little if any property tax benefit to the communities in which they reside but tend to consume considerable municipal resources (CRC Memorandum, 2011, page 5)

In the Nova Scotian context, the CCPA suggests a surtax placed on top of the provincial tax, with a locally set rate collected by the Canada Revenue Agency according to a tax filers postal code (CCPA, 2012, p. 28). One potential advantage of a municipal income tax that is not considered by the CCPA is the option to tax commuters, people who work in one municipality but live in another. These individuals often get characterized as using city services but not paying for them. Some US cities tax commuters in this manner through a payroll tax (New York City, however, repealed its payroll tax in 1999) (Kitchen & Slack, 2003, p. 2235) By having one rate (or set of rates) for income of people who live within the municipal unit and a lower rate for those who work within the municipality, the free rider syndrome of neighbouring municipalities poaching businesses or residents through attractive tax levels with limited services would be avoided. Residence and business patterns would more likely adhere to economic needs as opposed to being manipulated by free riders or rent seekers. Where price differences existed between municipal units they would more likely reflect true cost efficiencies as opposed to subsidies or service barriers, meaning that the benefits of competition would be maximized and more readily capitalized on by both service consumers and providers.
Assessing the potential for a Municipal Income Tax in HRM

In asking the question how modern Canadian municipalities should be funded going forward, Professor Wade Locke has undertaken a modeling exercise for a series of revenue alternatives in the Newfoundland context (Locke, 2011). His quantitative exploration reached many of the same conclusions as the qualitative analysis undertaken here: that a transition from inefficient and ineffective property based taxation to a blend of income and consumption based taxation is possible, and indeed on many grounds, preferable. Locke attempted to quantify the various changes that would result from such a transformation. His analysis is a good lesson in how complex such a transition could be, but it also demonstrates that such a shift can be accomplished while improving equity, certainty, convenience and efficiency.

In terms of residential property taxation in HRM, Kitchen and Slack (2003) did some estimates of possible new taxes and tax rates for a set of Canadian cities in 2000. For HRM, they estimated that a 1% surtax on provincial income taxes would raise about $6 million (p. 2236) and that to get $100 million the surtax would have to rise to about 16% (p. 2251). These rates are still roughly applicable today. According to HRM’s 2013 budget book, they expect to raise around $190 million from residents in 2013 (HRM, 2012, p. C15). According to Community Counts, HRM contributed $905.3 million (52%) of the provinces income tax take in 2008 (Nova Scotia Community Counts, 2012c). A ten percent surtax on that amount would give HRM approximately half of the $190 million it currently collects from individuals. A twenty percent municipal surtax would essentially eliminate the need for any residential property tax entirely.

On the corporate side, calculations become less certain. HRM represents 40% of the provincial population, 40% of the provincial GDP and is home to 50% of the provinces business enterprises (Statistics Canada, 2011b; Statistics Canada, 2012b; Nova Scotia Department of Finance, 2012; Greater Halifax Partnership, n.d.; Nova Scotia Community Counts, 2012d). So, while a similar concrete breakdown on the geographic source of corporate taxes is not immediately available, it seems reasonable to estimate that 40% of the $352 million the province took in in corporate income taxes in 2008 came from HRM. That would suggest a surtax of 137% would be necessary to replace the entire $190 million currently raised by commercial property taxes.

That surtax could be reduced however by a corporate tax on payroll (similar to the payroll taxes discussed by Slack and others), a lower rated tax on non-resident income earned in HRM (a commuter tax), or indeed a change to the provincial HST rate (as explored by Locke in Newfoundland). It should be noted that Slack and Kitchen (2003) advocated for a mix of taxes and urged that the focus be on user fees wherever possible (p. 2224).

Slack and Kitchen were, however, focused on generating new revenue for municipalities, not replacing outdated taxes to enhance equity, efficiency, clarity and convenience. In their pursuit for new revenue sources they highlighted the distortionary effects of a multiplicity of local tax rates on income and consumption and suggested that a solution to this would come through regional taxation and regional service delivery, two criteria HRM fits by definition (p. 2234). They also discussed the impacts of new taxes on fees in lieu and intergovernmental transfers. This again highlights the complexity of any tax review process and emphasizes the need for such a review to involve all levels of government as well as both taxes and service delivery (responsibilities and costs). A quantitative analysis on the scale of Professor Locke’s is required in order to give definitive advice around the equity, certainty, convenience and efficiency of the competing alternative mixes of any new consumption and income taxes. We can, nevertheless, make some larger generalizations based on the available literature.

Potential Budgetary Impacts in HRM
National, international and local experience has demonstrated clearly that the connection between property values and ability to pay is tenuous at best. In order to adhere to the maxims of effective taxation, municipalities should move to a blend of consumption and income taxes. Consumption taxes should be used wherever possible to deliver “luxury” services but also to act as a brake on free riding and rent seeking, where organized interests seek to secure a benefit for themselves at the expense of others. It should be noted here that the option of differential pricing based on income, or even some form of municipal income transfer or voucher system could be used to ensure equitable access while also allowing the maximum use of a fee for service model. Indeed, to the extent that national or provincial programs (or simple human decency) mandate universal access to certain basic programs such a transfer to individuals could be made by the provincial or federal government (for details on the arguments for and against such an arrangement, see for example Spencer (2012)).

Finally, income taxes should replace property taxes as the principal source of local revenue. Income taxes are simpler to administer, involve less local enforcement effort, are convenient for the tax payer and, provided they are simple and predictable, income taxes are more equitable than property taxes. While competition on rates is to be expected, even encouraged, this transition from property to income taxes should occur on a province wide basis to ensure maximum comparability for taxpayers and maximum administrative efficiency and cost containment by government.

However, as the CCPA recognized in their analysis, a transition to municipal income tax should not occur in isolation. To be as beneficial to the taxpayer as possible, the introduction of a municipal income tax should be accompanied by the reduction and eventual elimination of transfers from other levels of government. The service delivery responsibilities between governments should also be clarified at the same time to ensure the maximum connectivity between taxes collected and services rendered.
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