Executive summary

Funding a better future:

Progressive revenue sources for Canada's cities and towns

By David Thompson,
Greg Flanagan, Diana Gibson,
Laleah Sinclair and
Andy Thompson; PolicyLink
Research and Consulting.

CUPE

Executive summary

Canadian municipalities have limited revenues, but face growing responsibilities and costs. Municipalities need additional revenues to finance important public goods and services, and achieve other policy goals. The responsibilities of municipalities are increasing due to economic growth, offloading of services from other levels of government, environmental challenges and other factors.

There is recognition that new revenue-generating options should avoid being regressive – disproportionately hurting those with lower incomes – and should instead adopt a progressive structure that relies on those who are most able to pay. However, the literature on municipal revenue reform rarely provides a sustained focus on the impacts of various revenue-generating options on different income groups. This paper aims to spark much-needed discussion on the suite of available revenue options, their progressive or regressive impact on income and wealth, and the extent to which they could be designed to be fairer.

Taxes, spending and inequality

Municipalities collect approximately eight to nine per cent of all taxes collected by governments in Canada, down from 45 years ago when municipal taxes were 16.7 per cent of all taxes collected. Moreover, local government revenues have not kept pace with the economy. Instead, they have declined as a proportion of gross domestic product since 1961, dropping sharply since the early 1990s.

The largest revenue streams for municipalities are property taxes and user fees (fees from the sale of municipally-provided goods or services). These two categories have increased as a share of total municipal revenues over the last two decades, making up over 70 per cent of total revenues. The current reliance on property taxes and user fees is challenging for municipalities, as neither is indexed to economic growth, and both can be regressive. In contrast, the large majority of OECD member countries rely on a more balanced combination of income, sales, and property taxes to fund their municipalities.

Important drivers of increased municipal spending include: the infrastructure deficit caused by federal and provincial spending cuts in the 1980s and 1990s; the extensive and increasing impacts of climate change on infrastructure; demographic change; as well as economic growth and the demands it creates for services and infrastructure.

As in many other OECD countries, income inequality has risen in Canada over the last few decades, with only the richest increasing their share of national income. Independent of poverty, inequality is associated with many social problems, including poor education and health outcomes; lack of trust and reduced participation in community life; higher rates of addiction and obesity; and higher rates of violence and incarceration. Inequality is also a drag on the economy, reducing economic growth, efficiency, and productivity.

While federal and provincial taxes can be progressive overall, the heavy municipal reliance on property taxes and user fees means municipal revenues are regressive overall. However, while a revenue instrument may be mildly regressive, it could fund spending with social or environmental benefits that are progressive enough to outweigh the impact of the revenue instrument.

Municipal revenue sources

Municipal revenue-raising powers are provided and constrained by provincial legislation. In some provinces, municipalities have access to a relatively wide variety of revenue streams, while others rely more heavily on the property tax. Some larger cities have special statutes (often called "charters") that provide wider revenue-raising authority. This paper reviews a variety of existing revenue sources.

Property taxes and related taxes

In Canada, property tax revenues make up over 60 per cent of own-source municipal revenues (revenues raised by municipalities themselves, as distinct from grants and revenues shared by higher-order governments with municipalities). Property taxes are regressive, as lower-income families spend a much higher proportion of their income on property tax than higher-income families. Although the property tax is a tax on a type of wealth, it can be regressive in terms of overall wealth. The property tax doesn't tax financial assets, which tend to be held by the more affluent, and it applies to the total value of the property, not just the equity (people with lower levels of income and wealth tend to have higher mortgages proportionally).

The business property tax rate is often higher than residential rates, recognizing that business property taxes are income-tax deductible. A recent push to reduce business tax rates is narrowing this gap, making overall property taxes more regressive and heavier for local residents (business owners tend to be wealthier, and sometimes live in other jurisdictions).

A land transfer tax (LTT) is a tax payable on transfers of land ownership, based on a percentage of the property value. Most LTT rates in Canada are progressive in respect of the value of the property, ranging from zero to 0.5 per cent for low-value properties, to two per cent for higher-value properties. In addition, because the LTT is collected on land transfers, rather than ongoing ownership, it would tend to have a larger effect on those buying and selling properties more frequently, who are often higher income people.

User fees

User fees are charges levied for municipal goods or services. They are the second-largest municipal own-source revenue stream, after the property tax. User fees are sometimes charged for services that have broad positive social and economic benefits, such as public transit, health care, education, recreation, child care, and libraries. Attempting to fully recover the costs of providing these types of public services from users is administratively costly and penalizes lower-income people. However, some user fees can be designed to be less regressive.

Grants and revenue sharing

Higher orders of government have provided financial support to municipalities for many decades through grants and revenue sharing. Conditional grants designated for a specific purpose are much more common than unconditional grants, but don't necessarily address local priorities. Revenue sharing is a longer-term commitment of funding. Overall, the impact of grants and revenue sharing is relatively progressive: these revenue sources are funded largely by progressive income taxes (among other provincial and federal taxes), as opposed to regressive property taxes.

Consumption taxes

Consumption taxes come in two main categories: general sales taxes, and excise taxes that apply to particular items, also called selective sales taxes. American and European cities have access to sales taxes, and tend to rely less on property taxes than do Canadian cities.

Sales taxes place a higher burden on lower-income consumers, who tend to spend a higher portion of their income on goods and services and the sales taxes that apply to them. Some excise taxes apply to "luxury" items such as hotel accommodations. Other excise taxes can be levied on fuel, advertising, amusement, equipment, alcohol, tobacco and gaming. Fuel taxes, while regressive on their own, help reduce the human and economic costs of vehicle emissions, which can be very high, and disproportionately affect lower-income people. The substantial revenue from fuel taxes can be spent to provide an overall progressive effect.

Borrowing

Municipalities have a limited ability to borrow. The provinces generally disallow municipal borrowing to finance operating costs, and limit borrowing for capital costs. Municipalities can borrow on the general bond market, though government-facilitated financing facilities such as municipal financing authorities, revolving funds and infrastructure banks can offer better rates.

Gaming

Using casinos, slot machines and other gaming opportunities to raise revenues is tempting for municipalities, given that the revenues are high and the financial costs are low. However, lower-income people consistently spend proportionally more of their income on gambling than middle- and high-income people. Gaming leads to increased problem gambling, as well as small increases in crime and socioeconomic inequality.

Four revenue options and their relative progressivity

Together with the review of different revenue options, this paper provides added discussion of four revenue options, chosen because of their importance as existing or possible new municipal revenue sources, as well as their potential for making the overall revenue system more or less progressive.

Income taxes

The majority of developed-world municipalities have access to income tax revenues – a source of revenue that could significantly expand the fiscal capacity of Canadian municipalities and would increase with economic growth. Income taxes are generally progressive (marginal tax rates increase with income, while low- and no-income families are exempted from income tax), and are an important tool to reduce income inequality. Adding a municipal income tax to the federal or provincial income tax, or sharing a portion of those taxes (as the province of Manitoba does), would be more efficient to administer than municipalities collecting their own income taxes.

Local share of sales tax

Local sales taxes can also raise considerable amounts of revenue, while also ensuring non-residents pay for some of their use of municipal services and infrastructure. Adding on to existing sales taxes would be more efficient than direct municipal collection. While sales taxes on their own can have a regressive effect, they can generate billions of dollars to support public projects and services that have progressive impacts.

More progressive user fees

User fees can be designed to be more progressive, and to limit excessive consumption. Some regressive fees can be changed by adopting rates linked to consumption levels, while adding a "lifeline" zero-cost rate for modest levels of consumption (for example, for drinking water). Other techniques can also be used to reduce the regressivity of various user fees, including rebates, vouchers, and credits for lower income people. Such changes would not result in user fees that are progressive in the same manner as a progressive income tax, but they can make the suite of municipal fees less regressive.

Progressive property tax

Property taxes can be made more progressive in various ways. First, rates could be restructured by dwelling type, to provide lower rates for multi-family units, as some boroughs in Montreal have done (lower-income people tend to live more often in multi-family units, rather than single family homes). Property tax rates could be made higher for higher property values, much as income tax rates are higher for higher incomes. Restoring higher tax rates for business-owned property, and boosting the land transfer tax rather than the property tax, would make the overall property tax system more progressive. Finally, provincial governments can provide income tax credits to reimburse residents for a share of the property taxes they pay (a flat amount that phases out at higher income levels would be the most progressive).

Assessing the fairness of municipal revenue options

Emerging from the above discussion, a number of principles, or a "fairness screen" could inform analysis of potential revenue options:

1. Revenue sources with progressive impacts (such as a share of income taxes) should be used to displace revenue sources with regressive impacts (such as property taxes).
2. To the extent possible, municipally-controlled revenue sources should use rates tied progressively to income, wealth, consumption of luxuries, or other similar factors.
3. Where possible, basic consumption levels of essential goods and services should be exempt from user fees.
4. Where possible, revenues should come from taxing behaviours or goods that have harmful environmental or social impacts, rather than those with broad positive environmental, social or economic benefits.
5. Income-based tax exemptions, rebates and credits should be used to reduce the regressive impact of some taxes or fees and enhance progressivity.
6. In addition to analyzing new revenue options, existing revenue sources should be analyzed for their relative progressive or regressive impact.
7. Spending associated with a new revenue source (whether earmarked or simply established at the same time) should also be analyzed for its relative progressive impact. A somewhat regressive or neutral revenue instrument could be part of a larger policy initiative that includes a progressive spending element.

Conclusion

Municipal public services are both important and a great bargain for Canadians. Many of these services could not be purchased in the private market, and overall citizens save enormous sums by collaborating with their fellow citizens to "buy in bulk."

Canadians strongly support taxation to pay for municipal services, and particularly progressive taxation. Municipalities urgently need a wider range of revenue options. In assembling the revenue options that will enable future expenditures, municipal policymakers will need to pay attention to the fairness and equity impacts of both the revenue sources they choose, and how that revenue is spent.

May 2014 / cope491

To pre-order a copy of the full research paper, to be published in June 2014, visit cupe.ca/municipalities

CUPE has also produced an advocacy toolkit on progressive municipal revenue options. Visit cupe.ca/municipalities to download and order print copies of *Building better communities: A fair funding toolkit for Canada's cities and towns.*