

**ACCESSING NEW TAXATION REVENUE:
EVALUATING POLICY ALTERNATIVES
FOR BRITISH COLUMBIA'S CITIES**

by

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Abstract

This study explores how British Columbia can provide more financial autonomy to its cities by granting them access to more diverse taxation revenue sources. Three types of taxes are considered as policy alternatives: a municipal general sales tax, a municipal personal income tax and a municipal corporate income tax. Several implementation methodologies are also evaluated: tax rate setting authority, tax collection and tax revenue distribution. The evaluation relies on key informant interviews, case studies of U.S. cities that have already implemented the cited taxes and a review of previous literature. This study recommends that granting cities access to a local sales tax is the most practical first step in providing cities with more financial autonomy. However, access to a more diversified set of taxes, including corporate and personal income taxes, should be considered as next steps in granting city governments more flexibility to diversify their revenue sources.

Executive Summary

Policy Problem

The adequacy of municipal revenue sources has been a recurring issue in Canada's political agenda. In June 2006, the Big City Mayors' Caucus (BCMC), representing 22 of Canada's largest cities, including Vancouver and Surrey, released a report entitled "Our Cities, Our Future: Addressing the Fiscal Imbalance in Canada's Cities Today." In this report they complained that "the growing importance of cities has not been matched with updated financial arrangements that are appropriate to our new role" (p. 2). According to the BCMC, higher levels of government have downloaded responsibilities to Canadian cities without granting them the associated capacities to raise revenue. City governments in BC are seeing their traditional responsibilities expand to include social and poverty alleviation services. Furthermore, the concentration of rapid population growth within the core and along the outskirts of the cities has led to increased demands for municipal services and stress on the existing infrastructure.

Among the BCMC's recommendations is to provide municipalities with additional revenue-raising capacity to meet their residents' needs. With few exceptions, municipal taxing powers in Canada are limited to the property tax. The power of municipal governments to raise and spend revenues is granted to them in provincial legislation. The OECD (2002) recommends that provincial governments should work on legislative changes that would give cities access to other types of taxes. At the provincial level, the Union of British Columbia Municipalities reiterates the call for stable and predictable revenues to provide local governments with the finances needed to meet their responsibilities. Canadian researchers are also stating that a greater mix of taxation revenue would reduce the pressure on the property tax and would provide municipalities with the flexibility to utilize other taxation tools that could help finance municipal service delivery more efficiently and equitably.

This Report

This report explores how British Columbia can provide more financial autonomy and flexibility to its cities by granting them access to more diverse taxation revenue sources. Three

types of taxes are considered as policy alternatives: a municipal general sales tax, a municipal personal income tax and a municipal corporate income tax. These policy alternatives are compared to the status quo, which involves continued municipal reliance on the property tax with no access to supplemental tax sources. While evaluating these taxation alternatives, the following implementation methodologies are also evaluated: setting of the tax rate, collection of the tax and distribution of the tax revenue. The evaluation relies on material gathered through key informant interviews, case studies of U.S. cities that have already implemented the policy alternatives and a review of previous academic literature. The criteria used in this analysis are equity, revenue yield, impact on local economic growth, administrative efficiency, accountability and political viability.

Recommendations

This report concludes that implementing a local general sales tax is the most practical first step in expanding municipal revenue powers. However, access to a personal and corporate income tax would also improve the cities' fiscal flexibility. This report recommends a low universal sales tax rate which is to be set and collected by the Province in conjunction with the PST and remitted to municipalities. The remittance formula should be based on the locality of sale and, to a significantly lesser degree, the population of the municipality. In addition, the Community Charter and the Vancouver Charter should be amended to allow municipalities to increase the sales tax rate within a specified range. In this scenario as well, the tax revenues should be collected by the Province in order to promote administrative efficiency. All additional revenues generated from this local tax increase should be remitted to the municipality based on the location of sale.

My analysis shows that numerous problems can arise with a local sales tax. Sales taxes can discourage consumption and encourage the flight of commercial facilities to outside taxing jurisdictions. Another concern is the impact a sales tax would have on municipal land use incentives by encouraging land allocation to retail sales. Mitigating such consequences would require municipal officials to maintain a low rate and a low inter-municipal rate differential. The Province could also mitigate such consequences by specifying an allowable range for municipal sales tax rates.

Access to a sales tax will present municipal officials with the flexibility to lower the property tax rate while also meeting increasing service demands. In the long run, a case can be made for granting cities access to an even more diverse set of taxes to afford them greater flexibility in addressing their service delivery challenges and in distributing the cost burden. Such

taxes could include a progressive personal income tax imposed based on the location of work and a corporate income tax. A municipal corporate income tax should only be introduced if it can be tied with decreases in the property tax burden on businesses, a particularly acute issue in BC.

Dedication

To my parents, Françoise and Burt and my sister Mélina, whose love and personal experiences have always been a source of inspiration, support and ki.

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I want to thank all the individuals who participated in my capstone interviews, as well as Enid Slack and Doug McArthur for meeting with me to discuss my research. I also want to thank all my former co-workers at Infrastructure Canada, especially Jean-François Dionne and Dr. Margaret Hill, for having given me the initial opportunity to research this topic during my co-op term. Finally, best wishes go to all of my fellow classmates. I really enjoyed getting to know all of you over the past few months.

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1 Introduction

The financial prospects of municipal governments are a recurring theme in Canada's political agenda. Over thirty years ago, the Canadian Federation of Mayors and Municipalities warned that Canadian local governments were facing a growing financial crisis. In a report entitled "Puppets on a Shoe String", they argued for stronger, more autonomous municipal government in Canada with less reliance on conditional provincial grants and greater access to a wide range of tax revenues.¹ More recently, the Federation of Canadian Municipalities (FCM) released a report highlighting the growing gap between the services Canada's municipalities must deliver and what they can afford.² In June 2006, the Big City Mayors' Caucus (BCMC), representing 22 of Canada's largest cities, including Vancouver and Surrey, released a report entitled "Our Cities, Our Future: Addressing the Fiscal Imbalance in Canada's Cities Today." In this report they complained that "the growing importance of cities has not been matched with updated financial arrangements that are appropriate to our new role" (p. 2). Between 1995 and 2001, municipal revenues increased by 14 percent, while federal and provincial revenues increased by 38 percent and 30 percent respectively.³ According to the BCMC, higher levels of government have downloaded responsibilities to Canadian cities without granting them the associated capacities to raise revenue. Furthermore, the concentration of rapid population growth within the core and along the outskirts of the cities has led to increased demands for municipal services and stress on the existing infrastructure. Urban sprawl increases the cost of services such as roads, street lighting, pumping water, removing waste and expanding roadways and transit.⁴

City governments in BC are seeing their traditional responsibilities expand to include social and poverty alleviation services. In Vancouver, the Tenant Resource and Advisory Centre (TRAC) released a report in January 2007 stressing the need for local governments to get involved with the promotion of low-cost housing. They state that Greater Vancouver Regional District (GVRD) municipalities need to recognize that they, along with senior levels of government, are equally responsible for ensuring affordable housing. Alice Sundberg, executive

¹ City of Toronto (2000).

² Federation of Canadian Municipalities (2006).

³ TD Bank Financial Group (2002).

⁴ Ibid.

director of the B.C. Non-Profit Housing Association also stated that “municipalities need to acknowledge that they are one of the partners that are going to be involved in getting enough housing for people.”⁵

Among the FCM’s and the BCMC’s recommendations is to provide municipalities with additional revenue-raising capacity to meet their residents’ needs. The FCM observes that the revenue-raising options available to municipal governments in the United States and other OECD countries are much more flexible than those available to Canadian municipalities. In its latest territorial review of Canada, the OECD (2002) concurs that provinces in Canada exert more power over municipalities than in any other federation.

With few exceptions, municipal taxing powers in Canada are limited to the property tax. The OECD states that this high degree of reliance on property taxes is at the root of cities’ increasing fiscal problems. The City of Vancouver, for example, has been facing numerous protests from the local business community in the last few years due to its disproportionately high business property taxes.⁶ In June 2006, the BC Competition Council released a report entitled “Enhancing the Competitiveness of British Columbia” which stated that “the property tax imposed on major industry (Class 4) by some municipalities has reached the point where it is having a serious impact on the competitiveness of industry in those regions” (p. 32). The OECD (2002) recommends that provincial governments in Canada should make legislative changes to give cities some limited access to other types of taxes. Numerous Canadian researchers are also stating that a greater mix of taxation revenue would reduce the pressure on the property tax and would provide municipalities with the flexibility to utilize other taxation tools that could help finance municipal service delivery more efficiently and equitably.

At the provincial level, the Union of British Columbia Municipalities (UBCM) reiterates the need for stable and predictable revenues to provide local governments with the finances needed to meet their responsibilities. They address the issue of financial autonomy for local governments in one of their policy papers:

Local government should have access to a share of income and resource revenues which should be predictable as to the amount and timing of its announcement and the major portion of shared revenue should be in unconditional grants. (UBCM, 2004, p. 1)

⁵ Fowle (2007, pp. B1).

⁶ Vancouver Board of Trade (2002).

The power of municipal governments to raise and spend revenues is granted to them in provincial legislation. If the provincial government granted cities access to additional tax sources, advantages could accrue, including a broader distribution of the local tax burden and access to additional revenue leading to increased flexibility with regard to local conditions and circumstances. Nevertheless, introducing new local government taxes can have negative repercussions. For example, local income taxes can drive firms and employment to locations outside the city. Implementing a local general sales tax can have similar effects, by driving commerce outside of the city as well. Such effects need to be considered carefully in any policy reforms.

In this paper I explore how British Columbia can provide more financial strength to its cities by granting them access to more diverse taxation revenue sources. Supplemental access to three types of taxation are considered as policy alternatives: a municipal general sales tax, a municipal personal income tax and a municipal corporate income tax. The three policy alternatives are compared to the status quo, which involves continued municipal reliance on the property tax with no access to supplemental taxation revenues. While evaluating these taxation alternatives, I also evaluate the following different methods of implementing the policy alternatives: tax rate setting and limitations, tax base setting, tax collection and tax revenue distribution. The criteria used in this analysis are equity, revenue yield, impact on local economic growth, administrative efficiency, accountability and political viability.

Following this introduction, the second section of my paper offers an overview of previous research on the topic of municipal revenue sources. In the third section I provide a detailed description of my research methodology, followed by a description of the criteria used to evaluate the policy alternatives in the fourth section. The fifth section offers an overview of municipal revenue sources and constitutional rights in BC. The sixth section presents a comprehensive description of the policy alternatives. In order to carefully assess the policy alternatives, I need to consider how they will be implemented and their potential economic and social consequences. Thus, the seventh section presents case studies of U.S. cities that have already put into practice the proposed policy alternatives and explores their economic outcomes. American cities have greater taxing powers than their Canadian counterparts⁷ and their tax arsenal includes a heavier reliance on cyclically sensitive revenue sources such as general sales taxes and income taxes. I then present results from interviews with municipal and provincial public officials in British Columbia and national organizations in order to assess the policy

⁷ TD Bank Financial Group (2002).

alternatives' appeal and barriers to their implementation. The final section provides an overall evaluation of my policy alternatives and recommendations on how they could be applied in British Columbia.

2 Literature Review

The Canada West Foundation has published a series of studies on the topic of municipal revenue sources and financing options for service delivery. All of these articles elaborate on the problems associated with municipal reliance on the property tax and emphasize the need for new revenue sources. They call for a new partnership between cities and provincial governments based on consultation and consensus building, increased local autonomy and accountability and a new fiscal framework. The article most closely related to my paper is entitled “Big City Revenue Sources: A Canada-U.S. Comparison of Municipal Tax Tools and Revenue Levers,” by Vander Ploeg (2002). The author assesses the advantages and disadvantages of different locally raised revenue sources and compares the tax tools used by the six large western Canadian cities with those used by six of their American counterparts. Each of the six western Canadian cities was paired with a similar U.S. city. The city pairings include Vancouver-Seattle, Edmonton-Salt Lake City, Calgary-Denver, Saskatoon-Lincoln, Regina-Boise, and Winnipeg-Minneapolis. The study concludes that Canada’s cities lack diversity in the tax tools they use, especially when compared to American cities. My study is similar in comparing taxation tools used in Canada and the US. However, I take a more in-depth look at the implementation of these taxes in U.S. cities and the outcomes experienced. As such, more information is provided on how these taxation options could be applied in the BC context and how any repercussions might be mitigated.

My study also refers to Kitchen’s (2003) book, *Municipal Revenue and Expenditure Issues in Canada*. It discusses a variety of issues such as municipal expenditures and revenues, service delivery and the roles and responsibilities of local governments. Kitchen also highlights the need to diversify local tax resources and investigates the options available. He briefly evaluates five different potential taxes that could be implemented locally: the local poll tax, the local sales tax, the local income tax, the local fuel tax and the local hotel and motel occupancy tax. Each tax is evaluated based on its perceived negative and positive impacts. Although the evaluations are brief, they provide a theoretical context to the debate on taxes which will serve as a basis for my background analysis.

I will also consider the research of David Brunori, who states in his book, *Local Tax Policy: A Federalist Perspective*, that “the property tax is the only viable source of own-source

tax revenue for local governments”(2003, p. 4). In arguing in favour of the property tax, Brunori evaluates other local taxes such as the sales tax, the business tax and the income tax. His assessment of these taxes, along with his arguments for the property tax will be carefully considered when I evaluate my policy alternatives.

Enid Slack is another researcher whose work I will reference throughout my study. She has undertaken several studies analyzing the revenue raising capacities of cities in Canada. Her most relevant study, entitled “Revenue Sharing Options for Canada's Hub Cities” (2004), explores the mechanics of how Canadian municipalities can expand their taxation tools. Slack also evaluates, based on economic taxation principles, policy alternatives that are similar to the ones in my study. Her policy alternatives are: local personal income taxes, local corporate income taxes, local general sales taxes and local excise taxes. She states that “access to revenues from a mix of taxes would give Canada’s hub cities more flexibility to respond to changing expenditure needs” (Slack, 2004, p. 1). Slack and Kitchen’s 2003 study, “New Finance Options for Municipal Governments,” focuses on how additional revenues can be provided to local governments in Canada. New tax sources are among the revenue options considered. Other options considered include exemptions from the GST, intergovernmental transfers and more realistic payments in lieu of taxes from the senior levels of government. Among their conclusions is that:

Canadian municipalities should be able to levy a wider range of taxes than they are currently permitted to do. A mix of taxes would give municipalities more autonomy and flexibility to meet the demands for services and capital infrastructure. Moreover, municipalities should set their own tax rates, rather than sharing tax revenues with the federal or provincial governments. Only by setting rates themselves can municipalities be truly accountable (p. 2272).

Over the past several years, a few Canadian academics have also recommended that senior governments devolve new taxation options for their municipalities. In a 2003 book entitled *Paying for Cities*, Kneebone and McKenzie stated that the idea of imposing a local sales tax in Alberta deserves serious consideration. In a 2005 report for the Institute for Research on Public Policy, Courchene stated that:

Despite the potential for raising revenue within current jurisdictional constraints, this avenue will fall short of meeting cities’ expenditure requirements. As a result, current attention is focused primarily on ways that the senior levels of government can share their revenues with, or devolve new revenue bases to, cities (p. 18).

Most recently, the Conference Board of Canada released a report in 2007 that sets out priorities for giving Canada’s major cities the resources that will help them fulfill their potential.

The report states that “A broader mix of taxes would give municipalities more flexibility to respond to local conditions and a greater capacity to achieve different public policy objectives” (p. 93). It explains that sales taxes and payroll taxes allow local governments to share in the benefits of economic prosperity and can also capture the service benefits that non-resident commuters receive when traveling to the city for their work.

A contrasting view is presented by Mintz and Roberts (2006). They believe that exporting a local tax to non-residents of the city will hinder local government accountability and efficiency. They argue that additional tax fields for municipalities would not be warranted. Their reasoning is that municipal income taxes would hurt competitiveness, and a surtax on a PST would be very costly to operate in provinces with value-added taxes. They believe a more sensible approach would be to have social service costs shifted to the Province and for municipalities to raise more revenue through residential property taxes or user fees. Arguments presented in these studies favouring and opposing new municipal taxation options will be considered throughout my analysis.

3 Methodology

My study employs multiple research methodologies to answer each of the following questions:

- 1) What are the current principal provisions for raising revenue in British Columbia's cities?
- 2) What are the potential effects of my policy alternatives?
- 3) In what ways could my policy alternatives best be implemented?
- 4) What are the barriers to the implementation of my policy alternatives in BC?

The first question is answered in the background section and is based on information gathered from provincial legislation and existing academic literature. Financial data from City of Vancouver annual reports are presented to demonstrate current revenue sources and their changing trends. I examine provincial legislation on local governments in order to illustrate the constitutional provisions controlling municipal finances. Previous academic research is presented to provide more figures on the municipal revenue-raising environment.

The second question is answered by undertaking case studies of American cities that have already implemented one or more of my policy alternatives. For example, Philadelphia, along with other cities in the State of Pennsylvania, uses local payroll taxes on a large scale. A total of \$2.8 billion in local income tax was collected within Pennsylvania in 1998. I survey existing academic literature and official state and city government documents to explore the various economic outcomes experienced due to the implementation of additional local taxes. The case studies also provide information on how my policy alternatives could be implemented, thus answering the third question.

My policy alternatives have the following implementation options to consider:

- 1) Tax rate limitations: Should the Province set tax rate limitations?
- 2) Tax collection and distribution: Which level of government should collect the tax and how should it be distributed?

- 3) Tax rate setting: Which level of government should set the tax rate? Should the tax rate be uniform across neighbouring municipalities?

Interviews with municipal and provincial public officials in British Columbia further address the implementation issues while also answering the fourth question on implementation barriers. Interviews involve discussing what are perceived to be the biggest challenges associated with existing municipal revenue sources and how these challenges can be mitigated. Following this, I ask participants to evaluate the taxation alternatives, discuss their implementation options and give feedback on what they believe are the major barriers in their undertaking.

I believe that incorporating case studies and interviews into this paper add a more realistic perspective to the analysis. Case studies offer a means for contextually examining specific instances of an implemented policy. They help capture nuances that existing literature may have missed and ascertain whether implementation complied with expectations and intent. Naturally, the generalizability of the case studies is limited due to the presence of other interfering variables. Therefore, this analysis needs to carefully consider relevant differences between the American cities studied and British Columbia's cities.

Interviews supplement information gathered from existing literature by providing details on facts, perceptions, opinions and attitudes. Interviews also allow for ground-level feedback from those currently involved with policy making. Twelve individuals participated in this study. These included City Councillors for Vancouver and Surrey and senior managers working for the Cities of Vancouver, Surrey and Burnaby. At the provincial level, I interviewed public officials from the Tax Policy Department in the BC Ministry of Finance and the Local Government Services Department in the BC Ministry of Community Services. I also interviewed individuals from the Federation of Canadian Municipalities and the Union of BC Municipalities. Interviews were conducted with each individual separately and involved open-ended questions about the adequacy of current municipal revenue resources and about the implementation of potential policy alternatives that will help address the City's fiscal challenges.

4 Evaluation Criteria

The following criteria are used to evaluate my policy alternatives:⁸

- **Political viability:** This criterion largely depends on the visibility of the tax. Increasing the rate of a visible tax will likely have negative impacts on public acceptance. Perspectives of the provincial government, local citizens and businesses concerning the policy alternatives will also be taken into account.
- **Accountability:** This criterion depends on the level of financial autonomy bestowed upon the municipality by the Province. More specifically, it depends on the degree of tax limitations set by the Province. Financial autonomy promotes increased accountability. This criterion also depends on the visibility of the tax. According to Loreto and Price (1990), a visible tax promotes accountability.
- **Revenue yield:** This will depend on the stability and predictability of the tax yield relative to economic activity. It will also depend on the short and long term mobility of the tax base.
- **Equity:** This will be based on how the tax reflects ability to pay and also on whether taxpayers accrue most of the benefits paid for by the tax. More specifically, those who use municipally funded services should be the ones who pay most of the taxes for it.
- **Administrative efficiency:** The tax should be easy to administer. This largely depends on whether the tax can be collected by higher levels of government.
- **Impact on economic growth:** This depends on the mobility of the tax base and on the impact the tax will have on local employment and on local purchases of goods and services.

The criteria are used to evaluate my policy alternatives according to information gathered from existing academic research, interview participants and my case studies. Tradeoffs will naturally arise among the cited criteria. For example, municipal accountability and political

⁸ My selection of evaluation criteria was based on criteria used by Slack (2004) and Bird (1993).

viability are both strongly dependent on the visibility of the tax. Conversely, a visible tax is less politically acceptable, even though it promotes greater municipal accountability.

5 Background

5.1 Revenue Sources in Vancouver's Municipal Budget

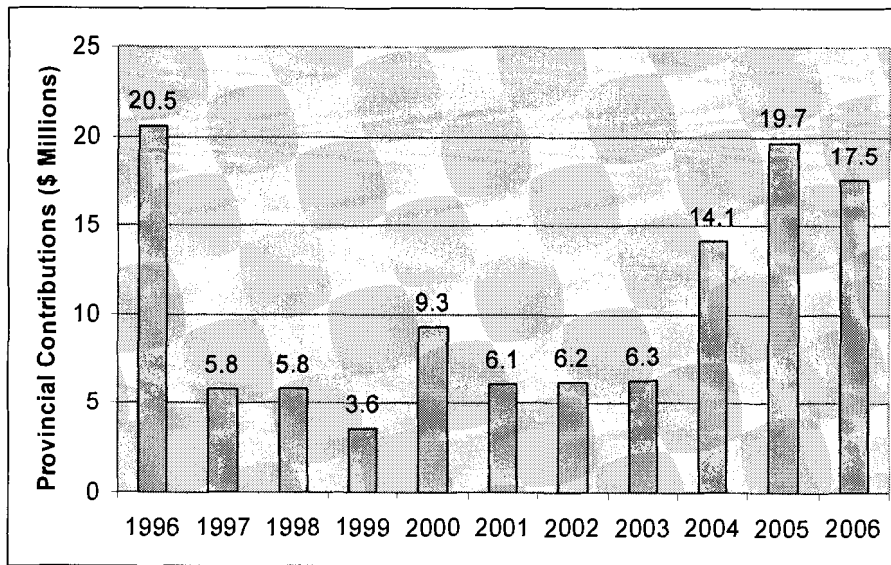
The Operating Budget for the City of Vancouver is funded by a combination of property taxes, utility fees, internal reserves, user fees and sundry revenues (which includes Provincial revenue sharing).⁹ According to the latest City of Vancouver annual budget, two main policies guide the formulation of the budget: budgets must be balanced and property tax increases must be kept near the rate of local inflation. From 2002 to 2006, Vancouver annual budgets have reported challenges meeting these policies due to the increasing cost of items such as:

- Annualized costs of council-approved programs;
- The cost of a number of priority funding requests most notably the addition of police officers and civilian staff for the Vancouver Police Department;
- Operating costs of new park facilities;
- Higher than inflationary increases in salary, equipment, fuel and insurance costs;
- Funding for the City's role in the 2010 Winter Olympics and the RAV Line;
- Increased investment in the city's cultural community;
- The increased cost of services provided by outside agencies such as the Emergency Communications for South West British Columbia (E-Comm) and the exemption of Berth Corridors from property taxation.

In addition, the Provincial government significantly reduced its contributions to City services in 1997. Figure 5.1.1 demonstrates the provincial financial transfers to the City of Vancouver from the fiscal years of 1996 to 2006. As the figure demonstrates, contributions have grown in 2004 and 2005. This is because of the Provincial government decision to transfer 100 percent of all traffic fine revenues to municipalities. In 2006, Provincial contributions to the City of Vancouver consisted of \$ 17.5 million, representing less than 2 percent of the City's operating budget.

⁹ City of Vancouver (2006b).

Figure 5.1.1 Provincial contributions to the City of Vancouver



Source: City of Vancouver(2006b)

Despite the recent increase in provincial contributions, the preliminary 2006 budget showed a shortfall of \$29.2 million, which required increases in property tax and user fee rates to eliminate. Indeed, year after year the City has faced the difficult choice of either raising property tax rates or reducing existing service levels in order to cover budget shortfalls. Council has taken part in public consultations with residents in order to seek input on these decisions. Table 5.1.1 demonstrates property tax increases from 2002 to 2006 and the proportions of municipal revenue they represent.

Table 5.1.1 Property tax increases 2002-2006 in fiscal years

Year		2002	2003	2004	2005	2006
Local Inflation		2 %	3.2 %	2 %	2.3 %	2 %
Property Tax	% Increase	4 %	4.67 %	2.93 %	2.99 %	4.04 %
	% of Budget Revenue	64 %	65 %	65 %	64 %	63 %

Source: City of Vancouver(2002, 2003, 2004, 2005, 2006b).

Due to the recent establishment of the Property Tax Policy Review Commission, Vancouver may soon incur problems in its ability to financially rely on property taxes. This commission was created by the City of Vancouver in response to complaints of disproportionately high business

property taxes in relation to residential property taxes. The mandate of this commission is to make recommendations to City Council concerning key elements of the City's property tax policy by June 2007. These elements include:

- Addressing the perceived inequity in the high share of the City of Vancouver's property tax levy that is paid by the non-residential property classes, as compared to the share paid by the residential property class;
- Recommending a strategy to enhance the stability and predictability of property taxes for individual properties in the face of sudden, large year-over-year increases in market value.

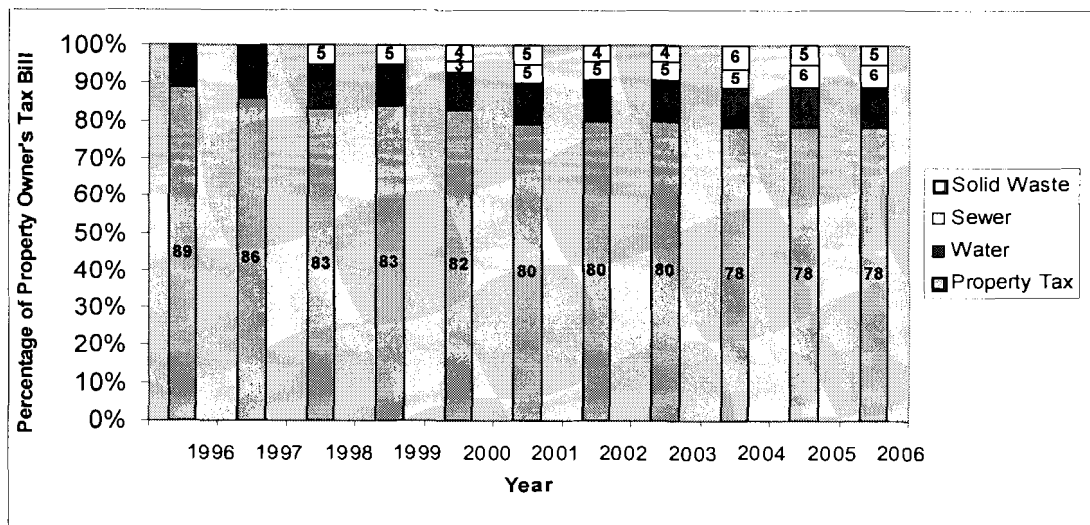
(City of Vancouver, 2006a)

In an effort to limit property tax increases, the City of Vancouver has raised utility fees at an even faster rate. Utility fees for solid waste, water and sewage have increased from 11 percent of the average¹⁰ property owners' tax bill in 1996 to 22 percent in 2006.¹¹ This is displayed in Figure 5.1.2.

¹⁰ This refers strictly to the city's portion of the property tax bill.

¹¹ City of Vancouver (2006b).

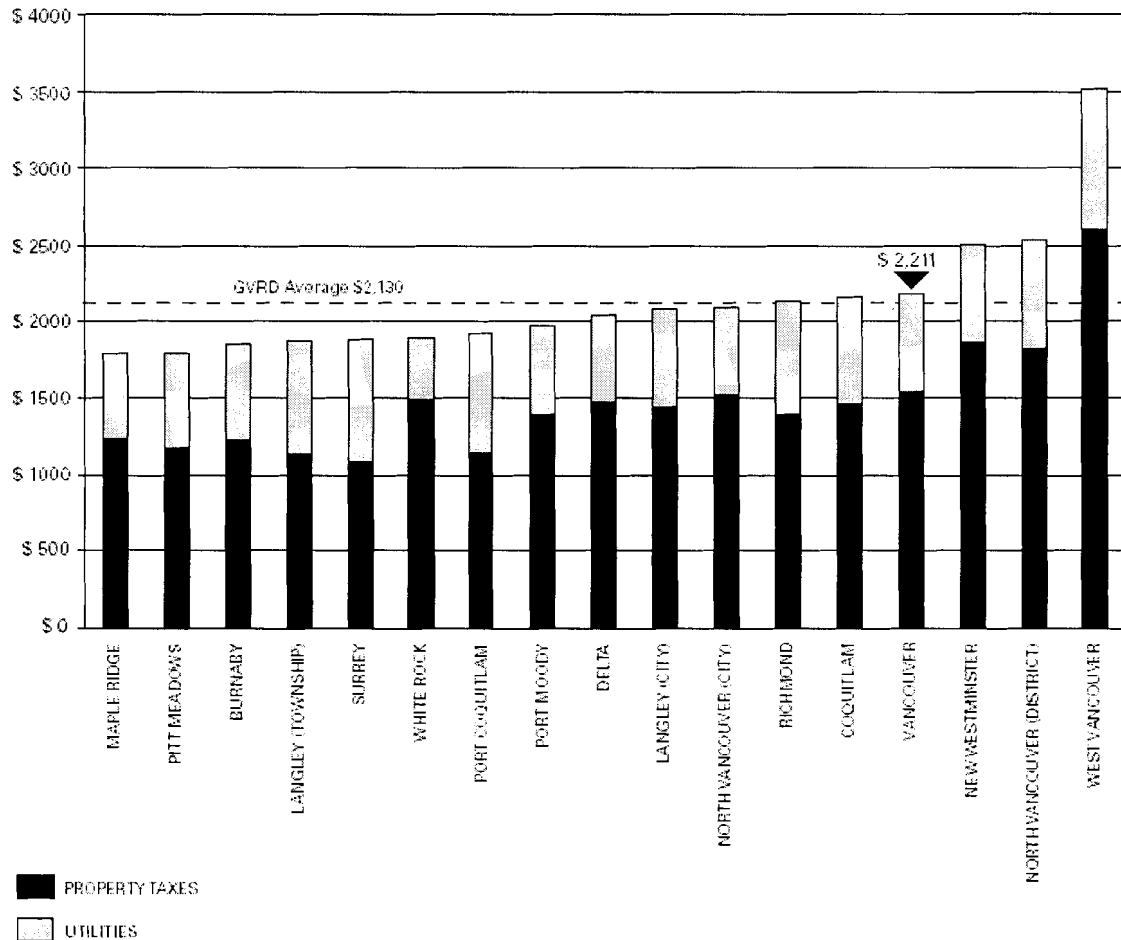
Figure 5.1.2 Property owner's tax bill: property taxes vs utility fees



Source: City of Vancouver (2006b)

Vancouver is not the only city reporting increases in utility fees and property taxes. In fact, the municipal property taxes and utilities paid in Vancouver are only marginally higher than the average paid in the GVRD. Figure 5.1.3 compares the property taxes and utility fees paid by homeowners throughout the municipalities in the Greater Vancouver Regional District (GVRD).

Figure 5.1.3 Property tax and user fees paid by homeowners in the GVRD for a home valued at \$585,924 (the average home value for Vancouver)



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According to Slack (2005), municipal accounting often does not tell the whole story about the fiscal sustainability of cities. She elaborates that insufficient fiscal capacity has led to municipalities under-investing in their infrastructure and services. In 2004, Infrastructure Canada conducted a literature review on Canada’s public infrastructure needs. They found estimates ranging from \$44 Billion for municipal infrastructure (stated by TD Bank Financial Group, 2002) to \$125 Billion for the total infrastructure shortfall (Mirza and Haider, 2003). They concluded that, given differences in methodology and scope, the magnitude of discrepancies make it difficult to arrive at an accurate figure describing the infrastructure deficit in Canada. Kitchen and Slack (2003) also acknowledge that much more research is needed to establish the state of municipal infrastructure in Canada, but they assert that change is needed since all studies done on the subject suggest that a large municipal infrastructure deficit exists and is growing.

Although municipal infrastructure projects are mainly financed through capital borrowing, governments must pay debt through their operating budgets. Therefore, limited revenue sources can constrain infrastructure investments. As stated by the Conference Board of Canada (2007), municipal governments have to “ensure that capital borrowing does not hinder their ability to deliver basic services and meet minimum debt repayments” (p. 88).

5.2 The Property Tax

As demonstrated in the previous section, the main revenue source for the City of Vancouver is the property tax. With few minor exceptions, it is the only tax municipalities are authorized to employ. According to the BC Ministry of Community Services,¹² property taxes generally pay for local government administration, staffing, debt servicing, leases, and the costs to provide services to the community. Such services include police and fire protection, garbage pickup, water and sewage facilities and libraries. Municipalities set their annual tax rates based on the revenue needs set out in their financial plan or preliminary budgets. Rates can differ depending on the class of property. Municipalities are required to collect property-based taxes on behalf of regional districts, school districts, hospital districts, BC Assessment, the Municipal Finance Authority, the Greater Vancouver Transportation Authority; and, BC Transit (Capital Regional District).

The property tax has its advantages in that property is immobile and therefore not likely to shift in location in response to the tax. According to Vander Ploeg (2002), the property tax is also stable, assures a reasonable level of compliance and yields relatively consistent and predictable revenues. The revenues are predictable because municipalities can set the rate each year once they have observed the change in total assessed property values. If property values decrease significantly, municipalities can still generate similar amounts of revenue by increasing the tax rate for that year. Compliance is also high, given the high visibility of properties to the local authorities and considering the inability to transfer the property until back taxes have been paid. Loreto and Price (1990) also argue that having a highly visible tax such as the property tax promotes government accountability.

However, heavy reliance on the property tax, which is the case for Canada’s municipalities, also has disadvantages. According to Slack (2004), the property tax is inelastic – it does not necessarily increase as the city’s general economy grows since it is restricted to the real estate aspect of the economy. Slack (2002) also argues that income taxes, not property taxes, should be

¹² British Columbia Ministry of Community Services (n.d.).

used to fund city social services since income taxes are more directly linked to the taxpayer's ability to pay. Indeed, the property tax does not link directly to an individual's income, but only indirectly through the value of a capital asset owned. The personal income tax treats home ownership extremely lightly by not imposing a tax on the imputed rental value of homes or the capital gains on the sale of a home. When taking this into account, it can be argued that the property tax helps balance out the favourable income tax treatment of real estate. However, property taxes may not reflect ability to pay in terms of a household's current cash flow. For those with low or fixed incomes, property taxes can be a significant burden.

Although the high level of visibility of property taxes may encourage government accountability, this characteristic simultaneously raises resistance to increasing tax rates. Property taxes also discourage investments in property, since homeowners will face an increase in the assessed values of their homes for taxation. According to Vander Ploeg (2002), the largest disadvantage of the property tax is that taxpayers are not necessarily the ones who benefit from the services funded by the tax. Commuters and visitors to the city consume the services provided by the city, such as transportation infrastructure, yet pay hardly any taxes to contribute to their provision.

Kitchen and Slack (2003) state that:

Whether or not property taxes are now too high, a case can be made for a greater mix of taxes at the municipal level. Such a mix would give municipalities flexibility to meet local needs at the local level. It would reduce the pressure on the property tax base to fund services that would be more appropriately financed in other ways. For example, income taxes would be better to fund services of a redistributive nature; sales taxes might be better to fund services that are used by commuters or visitors. (p. 2223).

It is difficult to prove that Canadian cities are fiscally unsustainable: infrastructure investment shortfalls are difficult to demonstrate and municipal deficits and large tax increases have not appeared in budgets because they are not allowed under council policies. Nevertheless, as Slack and Kitchen (2003) suggest, a greater mix of taxation revenue could play a significant role in increasing the efficiency and fairness of municipal service and infrastructure financing. In addition, the disadvantages of property taxes and the continued fiscal challenges faced by cities provide a strong justification for the diversification of municipal revenue sources.

5.3 Provincial Legislation of Municipal Revenues in BC

Under Section 92 of the *Constitution Act*, “Municipal Institutions in the Province” are under exclusive jurisdiction of the Province. This means that provincial governments establish the very existence, function, budget structure and form of local governments. The BC provincial government passed initial municipal legislation in 1873. This legislation allowed local governments to undertake a range of activities, but under stringent limitations (Smith and Stewart, 2005). Since then, many changes in municipal legislation have occurred. The most recent legal development in municipal autonomy is the *Community Charter*, which was given Royal Assent on May 29, 2003, and came into force on January 1, 2004. The stated purpose of the Act is to provide municipalities with:

- (a) a legal framework for the powers, duties and functions that are necessary to fulfill their purposes,
 - (b) the authority and discretion to address existing and future community needs, and
 - (c) the flexibility to determine the public interest of their communities and to respond to the different needs and changing circumstances of their communities.
- (British Columbia, 2003, Part 1: Section 3)

Although the City of Vancouver has its own charter, the *Vancouver Charter*, the enactment of the *Community Charter* has had strong implications for the city. By mandate, the City of Vancouver has the opportunity to adopt some or all of the provisions of the *Community Charter* but cannot exceed its limits. The *Community Charter* does not contain substantially different funding mechanisms than those existing under the previous *Local Government Act*. However it brings up for discussion a number of potential municipal revenue sources beyond the property tax such as the fuel tax, resort tax, local entertainment tax, parking stall tax, hotel room revenue tax, and road tolls (Smith and Stewart, 2005).

During the implementation of the *Community Charter*, several concerns have arisen. On the one side, the UBCM was displeased that the Province was still reserving the right to impose limits on property tax rates. The UBCM also complained that, while the Province promised no downloading of responsibilities onto municipalities without consultation, no consideration was made for the possibility that the Province could drop services that are a necessity to city residents, thus forcing the City to adopt responsibility for them.

On the other side, the Vancouver Board of Trade and the BC Business Coalition expressed discontent over the broadening of municipal powers. They questioned how broader

municipal powers would fit with the larger provincial agenda of reducing regulatory burden. Kenward (2003) explains that the disproportionately high non-residential property taxes occur “because municipal councils tend to be the most focused on the resident voter” (para. 51). He states that:

Because the *Community Charter* has broadened and enhanced municipal powers without a balancing broadening of protections and limits, the *Community Charter* to a significant extent directs that resident voter pressures (and municipal financial needs) are to predominate over economic interests whenever and to whatever extent a council decides they should. (Kenward, 2003, para. 48).

Although the *Community Charter* granted higher levels of autonomy to its cities, the Province still limits municipal fundraising abilities and explicitly prohibits municipal taxation of personal or corporate income and general sales. Cities across Canada are in a similar situation. Their access to taxation revenue sources is limited by the legislation of their respective provinces. None are allowed to raise funds through municipal taxation of personal or corporate income and general sales. Currently, City of Toronto mayor David Miller is publicly pressuring senior levels of government to grant municipalities’ access to sales tax revenue. In a campaign entitled “One Cent Now,” Mayor David Miller wants the federal government to give municipalities one cent of every six cents of goods and services tax collected in their communities. In December 2006, he stated in his inaugural speech:

We all recognize the City cannot continue to pay for the responsibilities of other governments that were downloaded over the last decade. We have received a strong mandate to tell the Premier and the Prime Minister that Toronto needs a one-cent share of the existing sales tax - and that we won't take no for an answer. It's what we need to build our City (Miller, 2006, para. 59).

Although the BC provincial government’s municipal constitutional amendments were limited with regard to increasing taxation powers¹³, revenue sharing schemes to promote local economic development were recently suggested by the Task Force on Community Opportunities. The Province established this task force to explore new approaches that will strengthen economic growth and deliver integrated, results-oriented services to communities. Chaired by the BC Minister of Community Services, the task force consisted of a diverse group, representing local government and the business community. Its final report was released to the UBCM’s 2006

¹³ According to Angela Deering, an interview participant from the BC Ministry of Finance, alternative taxation sources were contemplated when the Community Charter was being created. She states that at that time local governments agreed that the cost of administration for several small additional taxes or tax schemes outweighed the benefit obtained from the tax.

annual convention and explores why few regional economic development initiatives have been sustainable. Among the reasons cited, the report stated that:

Regional economic development has not been regarded as a key function of local government institutions and structures, which are designed primarily for service delivery ... [T]he economic rewards gained by local governments through taxation are lagged – since property taxes tend to respond slowly to changes in economic conditions – affecting the motivation of participants to sustain their efforts to realize economic gains over the long-term (p. 16).

The report elaborates that:

Whereas the provincial and federal governments see almost immediate taxation gains when regional economies prosper, through increased income, sales, corporate and resource taxation, governments at the local level see only modest gains through property taxes and even then, the gains tend to lag. The Task Force believes that there must be a way to deliver a much stronger, more immediate incentive for regions to commit to developing regional economic development plans, implementing these plans, and sustaining the regional alliances that monitor and manage the success of regional plans (p. 17).

The Task Force urges the UBCM to work with the provincial government in developing revenue-sharing programs for regions that agree to work together for economic development. It suggests that potential revenue sources could include a portion of incremental corporate income tax, personal income tax and consumption taxes that are directly linked to successful implementation of a regional economic strategy.

6 Policy Alternatives

6.1 Municipal General Sales Tax

In Canada, general sales taxes include the federal goods and services tax (GST) and, if applicable, a retail sales tax such as the provincial sales tax (PST) in BC. The GST is a multi-level value-added tax. The tax is a 6 percent charge (previously 7 percent before July 1, 2006) on the sale of all goods and services, except certain essentials such as groceries, residential rent, medical services, and services such as financial services. Businesses that purchase goods and services as inputs can claim input tax credits. The GST has accounted for 14.9 percent of the 2005-2006 federal budget revenues.

Every province except Alberta implements a PST or a harmonized sales tax. In the case of BC, a 7 percent PST is applied to retail sales. It applies to sales and leases of goods and to some services, such as repair and maintenance services. The Province of BC is currently completing a review of its PST to develop revenue-neutral options that will simplify, streamline and enhance the fairness of the tax. For the GST and PST, retailers act as the tax collectors for the provincial and federal government. If one percentage point of the PST were shifted to BC municipalities in 2006, the revenue would have amounted to a total of \$625 million in revenues distributed among BC municipalities.¹⁴ This represents about one fourth of the total amount of property tax revenues collected by municipalities (\$2.5 billion)¹⁵ in that year. The following municipal general sales tax design issues are considered in this analysis:

- 1- Setting the tax rate: Should the Province set the local tax rate? Should the rate be applied universally to all municipalities? A universal local sales tax at a mandated rate would, in effect, be a provincial tax that is shared with local governments on the basis of where the sale is made. It does not provide municipal discretion, nor accountability, over the rate of tax.

¹⁴ Calculated based on figures presented in British Columbia Ministry of Finance (2006).

¹⁵ British Columbia Ministry of Community Services (2006).

- 2- Tax collection and distribution: Should the Province collect the sales tax on behalf of the municipality and remit it? If so, how should the funds be distributed to municipalities? What should be included in the remittance formula?

6.2 Municipal Personal Income Tax

In Canada, the personal income tax is jointly applied by the provincial and federal governments. The federal government administers its own tax and the tax of every province except Quebec; it collects taxes on behalf of all the other provinces, using their choice of rate schedules, and remits the funds to those provinces. The federal and provincial income tax liabilities are calculated by taxpayers separately. If municipalities in BC were to have a 1 percent tax on all wages and salaries in the province, the revenue collected in the 2005-2006 fiscal year would have amounted to \$870 Million.¹⁶ This represents over one third of what was collected by BC municipalities in property taxes in 2006. Local personal income taxes, as operated in some of the American states, can take the following forms:

- **Wage tax:** A wage tax is generally a flat percentage of the gross wages or salaries of individuals, but sometimes it allows for an exempt amount of annual earnings. It is collected from individuals based on their municipality of residence, which is not always the same as their municipality of work. Since the tax is based on salaries, it excludes unearned income and is typically applied at a flat rate.
- **Payroll tax:** A payroll tax is a wage tax collected at the workplace directly from the employer rather than the employee. A payroll tax is levied on the basis of place of work rather than the place of residence of the worker. Payroll taxes exclude unearned income and are typically applied at a flat rate. The legal incidence of the payroll tax is on the employer, while that of the wage tax is on the worker. However, in the long run, the economic incidence of these two types of taxes is likely similar since the burden of the tax will be shifted from one party to the other as a function of their relative supply and demand elasticities.
- **General piggyback income tax:** This alternative involves using the same tax base as the federal or provincial income tax and links collection to that of federal or provincial income taxes. Such taxation revenues would be remitted to municipalities based on the location of the individual's work. This option

¹⁶ Derived by the author from Statistics Canada (2006).

involves broadening the base to include all income. It also involves using a progressive rate structure.

- Locally designed progressive income tax: This alternative involves using a locally set progressive income tax that takes unearned income into account along with labour earnings.

When determining which form of income tax would be most appropriate for municipal usage in the BC context, the following design issues will be considered:

- 1- The local tax base: Should the Province require that the local income tax be applied to the same base as the provincial tax? Should the tax be applied to the area of residence or the area of work?
- 2- Setting the tax rate: Should the Province set the local tax rate? Should the rate be applied universally to all municipalities? And should it be confined to flat rates, or should progressive rate schedules also be permitted?
- 3- Tax collection: Should the Province collect the income tax on behalf of the municipality and remit it?

6.3 Municipal Corporate Income Tax

In BC, the *Income Tax Act* levies provincial income tax on corporations that maintain a permanent establishment in BC at any time during a fiscal year. British Columbia corporate income taxes are administered by the Ministry of Small Business and Revenue in conjunction with the Canada Revenue Agency. The Province of British Columbia does not issue a separate corporate income tax business number or require a separate provincial corporate income tax return to be filed.

7 Case Studies of United States Municipalities

7.1 The Use of Local Taxes in the US

In the US, there is considerable variation across states in the limitations placed on municipal access to taxes. Next to the property tax, local general sales taxes are the most important source of tax revenue for many local governments. The first local general sales tax was adopted in New York City in 1934, when the depression put pressure on local governments to diversify their revenue sources. New Orleans and Philadelphia followed in 1936 and 1938. By 1970, 3400 local governments were using the tax with 24 states authorizing its use.¹⁷ Now 31 states and the District of Columbia authorize local sales taxes (The Conference Board of Canada, 2007).

California illustrates the extensive use of sales tax by lower jurisdictions. In the 2001-2002 fiscal year, municipalities in California raised US\$4.63 billion from local general sales taxes, the most of all the states. In California, the basic state-wide sales tax rate is 7.25 percent and is divided as follows:¹⁸

- 6.25 percent State
- 0.75 percent Local Jurisdiction Fund (city or county of place of sale or use)
- 0.25 percent Local Transportation Fund (county of place of sale or use)

California also has many special taxing districts, which are funded by a sales tax rate that is added to the standard state-wide rate of 7.25 percent. The tax rates for these districts are limited by the State and must range from 0.125 percent to 0.50 percent per district. Some areas have no additional district tax in effect, while other areas are affected by more than one district tax. Sales taxes in the State of California are collected by the State Board of Equalization, the only publicly elected tax commission in the United States.¹⁹

¹⁷ Tax Institute of America (1970).

¹⁸ California State Board of Equalization (n.d.).

¹⁹ Ibid.

Municipalities in New York and Texas also raised high amounts of revenue from the general sales tax in the 2001-02 fiscal year – US\$3.55 billion and US\$2.64 billion, respectively.²⁰ That same year, municipalities in nine other states raised over \$1 billion in revenue from local general sales taxes. These states are Alabama, Arizona, Colorado, Florida, Illinois, Louisiana, Missouri, Oklahoma and Washington.

The frequency of use of the general sales tax by local governments varies widely for each state. All counties and cities levy a general sales tax in Virginia, but the tax is used by only one city in each of Arkansas and Minnesota. In most states, the local sales tax is collected and administered by the state collection agency and then returned to the tax locality. Louisiana and Alabama allow local governments to administer their taxes separately. Therefore, retailers in those states are subject to additional filing requirements.

Wage and payroll taxes are also used by U.S. local governments, but less widely than general sales taxes. In 1995, it was estimated that 4,000 local governments levied some form of wage or payroll tax. However, only 32 of these governments were in cities of over 50,000 people.²¹ The first local payroll tax was adopted by Philadelphia in 1938 as a flat tax on all earned income within its boundaries (ACIR, 1988). It was considered progressive because of an exemption of the first \$1,000 of income. Between 1940 and 1962, other localities adopted a similar model of income taxation. In 1962, Detroit extended the tax to include all forms of income including unearned income such as dividends, rental income, interest and capital gains. The next major change occurred in 1967, when New York City introduced an income tax with personal deductions and graduated rates (ACIR, 1988).

By 2003, 15 states allowed local governments to tax some form of personal income. In two of these states, Arkansas and Georgia, no local governments have opted to make use of it. In 2004 it was reported that only four states and the District of Columbia relied on income taxes for more than 15 percent of their tax revenue.²² In the 2001-2002 fiscal year, municipalities in New York raised US\$7.45 Billion from local income taxes, the most of all the states. Next were municipalities in Ohio and Pennsylvania, which raised a total of US\$3.3 billion and US\$1.39 billion respectively²³. Local income taxes are generally imposed as a flat rate ranging between one and five percent. In some cases, the tax is divided between the jurisdiction where the person resides and works, and a lower rate is often applied to commuters. Currently, Philadelphia

²⁰ U.S. Census Bureau (2005).

²¹ Hy and Waugh (1995).

²² Schwartz (2004).

²³ U.S. Census Bureau (2005).

employs a payroll tax which excludes unearned income, and the tax is paid as a flat rate directly by employers in the city on their wage bill. In Pennsylvania, different rules apply to Philadelphia as opposed to other jurisdictions in the state. The tax rate in Philadelphia is greater than that allowed in surrounding areas. Philadelphia also has first claim to the income tax earned by non-residents of the city. Meanwhile, in other parts of the state, the jurisdiction of residence has the first claim to the individual's income tax (ACIR, 1988).

In New York City, all forms of income are taxed with a locally designed progressive rate structure. Non-residents who worked in the city had to pay a flat-rate earnings tax, until the non-resident income tax was repealed in 1999 (Schwartz, 2004). Maryland levies a piggyback tax, where the state collects the tax and remits the local portion to the local government serving the resident's area. In Ohio, Pennsylvania and Kentucky, local taxing jurisdictions cooperate in the administration and collection of the tax by combining taxes of local jurisdictions on a single return submitted to a joint collection agency.

States also vary in their authorization of local income taxes. New York only authorizes two cities to levy an income tax – New York City and Yonkers. Ohio and Pennsylvania, in contrast, grant broad authority to their municipalities. Consequently, there is a high level of variance in local tax rates throughout Ohio. Kentucky, Iowa, Pennsylvania and Ohio also allow school districts to tax income.

The first local income tax on corporations was enacted in Toledo, Ohio in 1946. By 1970, 341 local governments were raising revenue through this tax. Most of them are in Ohio, but some are also in Kentucky, Michigan, Missouri, Oregon, Pennsylvania and New York.²⁴ Six states allow local governments to tax businesses on the basis of payroll.

Like in Canada, property taxes in the U.S. generally account for the largest share of local government tax revenue. Intergovernmental transfers also represent a significant share. In 1902, transfers accounted for about 6 percent of local government revenues. This figure increased to 40 percent in 1980 but then declined to about 34 percent by 1996.²⁵ Local governments have relied on income and sales taxes as a method of diversifying their revenue sources, offsetting the reliance on the property tax and supplementing current sources in order to meet additional expenditure needs. Rarely have such tax sources been used to completely replace the property tax.

²⁴ Tax Institute of America (1970).

²⁵ Schwartz (2004).

7.2 Outcomes from Local Taxes in the US

In order to analyze potential consequences of drawing revenue from other taxation sources, Table 7.2.1 summarizes some of the consequences identified in U.S. municipalities. In many of these studies, estimated elasticity figures represent the magnitude of the taxes impact. An elasticity represents the ratio of the incremental percentage change in the value of one variable with respect to an incremental percentage change in the value of another variable.

Table 7.2.1 Case studies of local taxation in the U.S.

City	Tax	Reported Consequence
New York City 1970-2001 ²⁶	Income tax	<p>Job loss: The city's local top marginal income tax rate rose from 2 percent in 1970 to 4.66 percent in 1994 and then fell for a sequence of three reductions to 3.592 percent by 2001. Meanwhile, New York City had 5.28 percent of U.S. jobs in 1970. This has dropped to 2.88 percent in 2001. The elasticity formula derived from this data estimated that New York City lost 331,338 jobs by 2001 because of these increases in city income tax rates. The loss of jobs would have been much larger, at 487,913 jobs, had the City not started cutting tax rates in 1994. The elasticity of city jobs with respect to income tax rate changes was estimated at -0.2. This means that city jobs decreased by 0.2 percent for every one percent increase in the income tax rate.</p> <p>Decrease in retail sales: The estimated elasticity of the tax base with respect to changes in income tax rates ranged from -0.46 to -0.53. This means that sales decreased by 0.46 to 0.53 percent for every one percent increase in the income tax rate.</p>
New York City 1970-2001 ²⁷	Sales tax	<p>Decrease in retail sales: The estimated elasticity of the tax base with respect to changes in sales tax rates ranged from -0.47 to -0.52. This means that sales decreased by -0.47 to -0.52 for every one percent increase in the sales tax rate.</p>
Philadelphia 1970-2001 ²⁸	Gross receipts	<p>Decrease in reported taxable receipts from business sales: Increases in the city's gross receipts tax rate reportedly reduced overall</p>

²⁶ Haughwout, A., Inman, R., Craig, S., & Luce, T. (2004).

²⁷ Ibid.

²⁸ Ibid.

	tax	business activity in the city. The estimated base-to-rate elasticity ranged from -0.19 to -0.27, which indicates that business activity decreased by -0.19 to -0.27 percent for every one percent increase in the gross receipts tax rate.
Philadelphia 1970-2001 ²⁹	Wage tax	Job loss: The city's weighted average wage tax rate rose from 3 percent in 1971 to a peak of 4.766 percent in 1995. Since 1996, it was reduced to 4.384 percent in 2001. Meanwhile, the share of national jobs has declined from 1.24 percent in 1971 to 0.52 percent by 2001. The elasticity formula derived from this data estimated that Philadelphia lost 172,889 jobs between 1971 and 2001 because of the increase in the city's wage tax rates. The loss of jobs would have been 202,291, had the City not started cutting tax rates in 1996. The elasticity of city jobs with respect to wage tax rate changes was estimated at -0.4. This means that a 1 percent increase in the wage tax rate led to a 0.4 percent decrease in city jobs. According to Inman (2005), the larger effect for Philadelphia in comparison to New York City likely reflects the relatively larger tax rate on commuters in the city.
Philadelphia 1990-2000 ³⁰	Wage tax	Decrease in city land values: the elasticity of city land values with respect to the wage tax was estimated at -0.2. Therefore, a 1 percent increase in the wage tax rate led to a 0.2 percent decrease in city land values.
86 large U.S. cities 1972, 1977 and 1982 ³¹	Income tax	Reduction in property tax base: A 10 percent increase in the income tax rate was estimated to have decreased the property tax base by 0.65 percent. This means the elasticity of the property tax base with respect to the municipal income tax was estimated at -0.07.
86 large U.S. cities 1972, 1977 and 1982 ³²	Sales tax	No reduction in property tax base: A 10 percent increase in local sales taxes did not appear to have any effect on the property tax base.
Illinois' cities	Sales tax	Property to sales tax shift: Revenues from sales tax receipts among

²⁹ Ibid.

³⁰ Inman (2003).

³¹ Ladd and Bradbury (1988). The study also found that a property tax increase had the highest effect on the property tax base – the estimated base-to-rate elasticity was -0.15.

³² Ibid.

1970-1980 ³³		Illinois' 50 largest cities increased from 37.8 percent of locally generated revenues in 1970 to 46.3 percent in 1980. In the large cities of Illinois (population of over one million), the average ratio of sales to property tax revenues increased from 0.125 in 1974 to 0.387 in 1982.
California cities 1990-1993 ³⁴	Sales tax	Inequity in city revenue-raising capabilities and local government incentive for urban sprawl: A multivariate statistical analysis indicated that a city's per capita sales tax revenues can be partially predicted based on certain city characteristics. The findings revealed that sales tax revenues are positively related to the following city characteristics: higher populations, lower densities, and fewer persons per household. Such characteristics are also significant factors of urban sprawl.
California cities 1971-1995 ³⁵	Sales tax	Increase in retail land uses: Surveys of administrative officials in 330 cities throughout the state provided strong evidence that city governments systematically favour retail land uses over other types of developments. The survey results were integrated with an analysis of recorded revenue distributions from 1971 to 1995. The analysis supported the argument that there has been a "fiscalization" of land-use decisions: "Retail land uses are preferred over residential and heavy industrial uses by a substantial margin. City policymakers pursue land uses that generate high levels of sales tax revenues—shopping centers and auto malls." ³⁶

³³ Krmenc (1991).

³⁴ Lewis and Barbour (1999).

³⁵ Ibid.

³⁶ Ibid. (p. 4)

West Virginia Counties 1979-1984 ³⁷	Sales tax	“Border tax” effect on sales levels: Counties in West Virginia which border Kentucky, Maryland, Ohio and Pennsylvania are affected by a sales tax differential that has induced consumers to travel to low-tax locations to shop. When the sales tax is phased out, increases in grocery store sales are most rapid in such border counties. The study found that a 1 percentage point drop in the sales tax rate in West Virginia border counties led to increases in grocery store sales of about 5.9 percent.
Dayton, Ohio 1970 ³⁸	Income tax	No locational effect: Dayton Chamber of Commerce officials reportedly unanimously agreed that local income taxes had not slowed the expansion of business activities in their communities. Lower property tax rates and additional public services were frequently cited to have offset any negative impact of the income tax.
Lexington, Kentucky 1972 ³⁹	Income tax	No locational effect: The Lexington Chamber of Commerce reported that they have no evidence demonstrating that the local income taxes have ever influenced businesses to locate outside of the taxing district.
Maine 2001 ⁴⁰	Sales tax	Business opposition: Local governments in Maine supported an initiative that would allow them to impose a sales tax of up to 1 percent. However, the state legislature refused to consider the proposal, reportedly because the business community lobbied against it, citing the detrimental effects of such taxes on economic development.
Baltimore, Maryland 1972 ⁴¹	Income tax	Low administrative and compliance costs: Due to its reportedly low administrative and compliance costs, the Baltimore piggyback income tax has been carefully studied.
Ohio municipalities 2000 ⁴²	Income tax	High Administrative and Compliance costs: A report was released complaining of Ohio’s complicated, ambiguous, inconsistent and procedurally complex municipal income taxes
District of	Sales tax	Decrease in food sales but not in aggregate sales: Food sales in the

³⁷ Walsh and Jones (1988).

³⁸ Smith (1972).

³⁹ Smith (1972).

⁴⁰ Brunori (2001).

⁴¹ Smith (1972).

⁴² Schmarr and Spretnak (2000).

Columbia 1962-1976 ⁴³		District of Columbia declined by seven percent for each one percentage point increase in the differential of the D.C. sales tax rate with its neighbours. No significant effect of the tax-rate differential on aggregate sales was detected.
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As shown in table 7.2.1, U.S. cities have a wealth of experience when it comes to local taxation and its economic consequences. With sales taxes, the most frequently reported consequence was a decrease in local sales. Sales taxes have also reportedly generated considerable business opposition and have been found to impact local land use decisions. They have also generated inequities in the revenue-raising capabilities across cities. With regards to the income tax, some cities have experienced high administrative costs and an exodus of businesses and jobs, while in other cities, no such impacts have been detected. It is possible that some of the variations in the levels of economic difficulties are a result of how the taxes were implemented. For example, low rates and rate differentials among surrounding jurisdictions can play a strong role in limiting incentives to relocate.

The U.S. Advisory Commission on Intergovernmental Relations (ACIR) published a series of recommendations in 1948, 1974, 1988 and again in 1989 in order to promote metropolitan coordination of local sales and income taxes and mitigate the negative repercussions of these taxes. In aggregate, these recommendations were:

- **Uniform Tax Base:** The state should provide a uniform local tax base which should conform to that of the state if the state imposes the levy.
- **State Administration:** The state should collect and administer the local income or sales tax and designate or create a state agency to administer the local tax if the state does not impose such a levy.
- **Universal or Widespread Coverage:** The state should encourage universal or widespread coverage by mandating a minimum local rate and permitting counties and those cities with populations of at least 25,000 to choose a rate above this, subject to a specified maximum, or otherwise by giving first option to adopt the tax to the local government of widest jurisdictional reach with sharing provisions for municipal governments. The authority to adopt local sales and income taxes should also be extended to cities with

⁴³ Fisher (1980).

populations of at least 25,000 if the larger unit of general government does not adopt the tax.

- **Constrained Rate Option:** The state should permit flexibility by specifying a range of tax rates that general purpose local governments may impose.
- **State Equalization:** The state should seek to minimize local fiscal disparities in those states characterized by a high degree of local fiscal responsibility and a fragmented local governmental structure. It should adopt an equalizing formula for distributing local non-property tax revenues among constituents within the local taxing authority of widest jurisdictional reach. It should also adopt new programs or use existing state programs of general support to offset fiscal disparities among local taxing authorities with the widest jurisdictional reach.
- **Income Tax Sharing:** The state should specify arrangements for sharing taxes on earned income by non-residents between tax levying jurisdictions of residence and employment.

8 Interviews

The following twelve individuals were interviewed for this study:

1. Ken Bayne, Director of Financial Planning and Treasury, City of Vancouver
2. Rhoda Howard, Assistant Director of Planning, City of Vancouver
3. Karen Levitt, Manager of Financial Planning, City of Vancouver
4. Peter Ladner, City Councillor, City of Vancouver
5. Rick Earle, Director of Finance, City of Burnaby
6. Suzanne Fillion, Manager of Budgets and Reporting, City of Surrey
7. Marvin Hunt, City Councillor, City of Surrey
8. Brian Walisser, Executive Director of the Policy and Research Division, Local Government Department, Ministry of Community Services, Province of BC
9. Dale Wall, Assistant Deputy Minister (ADM) for the local Government Department, Ministry of Community Services, Province of BC
10. Angela Deering, Tax Policy Analyst, Tax Policy Branch, Ministry of Finance, Province of BC
11. Christian Laverdure, Deputy Director, Federation of Canadian Municipalities
12. Alison McNeil, Senior Associate, Policy and Programs, Union of BC Municipalities

Interview participants were asked questions about the adequacy of current municipal revenue sources, the feasibility of accessing other taxation sources, the presence of other policy alternatives that will address municipal fiscal challenges and the implementation barriers of having municipalities access other taxation revenue sources. All opinions expressed by interview participants are reflective of the individual's opinions solely and are not representative of their organization's official stance on any issues.

8.1 Current Municipal Revenue Sources

Over the course of the interviews, all municipal public officials expressed concerns about the current revenue sources their municipality can access. Christian Laverdure, the Deputy Director of the Federation of Canadian Municipalities, believes it is difficult for municipalities to establish a long-term funding framework with their current revenue sources. He explains that different municipalities experience different sets of problems due to their limited revenue. Some of the problems are related to the financing of homelessness programs and water management services. Ken Bayne, the Director of Financial Planning and Treasury for the City of Vancouver, points to affordable housing and community services as among the City's biggest funding challenges. Bayne states that "there was a time when the federal and provincial government funded housing programs, but now there is less money in this area. Citizens are demanding municipalities to step in and start using their resources to build housing." He elaborates that this is not something municipalities should be taking on with property taxes as the source of funding. With regards to community service organizations, Bayne explains that since the Province withdrew grants, these organizations are now turning to the municipalities for replacement funding. Karen Levitt, the Manager of Financial Planning for the City of Vancouver, refers to recent incidents of building squats by local anti-poverty groups while explaining that increasingly, services are being downloaded to local governments by senior governments, and in some cases these downloaded services require income redistribution.

Rhoda Howard, Assistant Director of Planning for the City of Vancouver, also cites affordable housing and homelessness as examples of National issues the City has had to address. She explains that in the past, cities have partnered with senior levels of government to provide housing services. The City would provide land while National and Provincial governments would provide the funds to operate the projects. However, the City is now losing its partners in housing provision and is facing the issues largely on its own. Peter Ladner, City Councillor for the City of Vancouver, believes the biggest inadequacy is with transportation. He explains that Translink is severely hampered in delivering basic transportation services because of its limited access to funding mechanisms.

In the City of Burnaby, Rick Earle, the Director of Finance, has also brought up housing as an issue that is beyond the financial capabilities of Burnaby. He further cites infrastructure maintenance as a major funding challenge. The City of Burnaby will soon need to replace all of their water pipes since they are reaching the end of their economic life. Such a project is funded

through borrowing from the Municipal Finance Authority, but Earle explains that borrowing is no different than a mortgage – you still need to make the monthly payments and the payments for debt financing come from the property tax levy. Earle also explains that Lougheed highway and all other local highways except for Highway 1 used to be maintained by the Province, but they have been shifted to the City of Burnaby. Marvin Hunt, City Councillor for the City of Surrey and the past president of the UBCM, also discussed the challenge of highway maintenance. Recently, the Province put the City of Surrey in charge of three of their main highways – King George Highway, Scott Road and the Fraser Highway.

The adequacy of the property tax was also widely discussed by municipal public officials. Most of them appreciate the tax for its stability, predictability and its low compliance and administrative costs. Ken Bayne points out that it is a suitable tax for the provision of services such as roads, police and fire protection, which consist of services to property. However, the property tax becomes less adequate as the City's responsibilities expand to include more social services. According to Karen Levitt, the property tax is problematic because it can be a capital tax on wealth rather than a tax on income and consumption. Peter Ladner also expressed concern about the extent of reliance on a tax source that does not relate enough to income or services consumed. Levitt noted that some provisions are in place to mitigate problems associated with the property tax. Businesses can deduct their property tax as a business expense in their income taxes. There is also a tax deferral program, where the Province provides low-interest loans to senior or disabled homeowners for their annual property taxes, which are to be repaid at the time the property is sold. Rick Earle believes the property tax is at a saturation level, especially on the commercial side. Businesses pay tens of thousands of dollars a year in property taxes, he explains. Marvin Hunt also remarked on the high property tax rates businesses are facing. He explains that businesses are complaining that even when revenues are poor, they still have to deal with the fixed cost of the property tax. Hunt also brought up past incidents with the local ports and BC rail, where property taxes got so high the Province had to intervene.

Aside from the property tax, other revenue sources were discussed. To alleviate the problems associated with property taxation, many cities have reportedly created more utility fees. The City of Vancouver now charges utility fees for water, sewage and solid waste. The option is good for environmental sustainability, but, as Karen Levitt reports, when sewerage and solid waste utility fees were introduced in the mid-1990s, there was a shift in costs borne by lower-valued properties. Earle reports that Burnaby's water rates are going up by about 9 percent a year and, now that a water filtration system is being constructed, water rates will increase even more. Ken Bayne notes that the City has increasingly used development cost levies to provide for the

cost of growth. Levitt remarks that the City of Vancouver continues to strive to control costs by maximising operating efficiencies. City public officials state that they've done as much as they can in raising revenue from their available means. Ken Bayne explains that there isn't a lot more out there that would make a difference to them and be politically feasible. One area they can raise money is business licence fees. The Vancouver Charter authorizes the generation of surpluses through business licence fees. However, Bayne explains that Council has never been open to utilizing this revenue tool because it is another tax on business and it is not any fairer than the property tax.

Dale Wall, the ADM for the local Government Department in the BC Ministry of Community Services, acknowledges that, considering the issues they face, municipalities such as Surrey and Vancouver are becoming fiscally challenged, especially now that they are taking on more social issues such as homelessness. He believes there is still property tax room available to municipalities. He explains that although the property tax is high for business properties, the general rate is lower in BC than in other Canadian municipalities. However, considering the political realities, he understands that it's hard for BC municipalities to take advantage of the tax room. Wall also stated that another concern is to keep municipal development cost charges from getting too high. Brian Walisser, Executive Director of the Policy and Research Division of the Local Government Department in the BC Ministry of Community Services, says that in the case of BC municipalities, there is no empirical evidence demonstrating that property taxes and fees have been saturated (though he expressed concerns about how the tax burden is distributed among property classes). He also explained that outside of Ontario, Canadian municipalities have little responsibility for equity services such as health, housing or welfare and that recent changes in municipal finance have been good for municipalities: there is now a steady flow of gas tax money and provincial government transfer programs have been enriched. Angela Deering, a tax policy analyst with the BC Ministry of Finance, also believes that municipalities have a number of financial tools to raise needed revenues, especially since the Province has made considerable advances in granting some municipalities additional revenue sources. She cites items such as the fuel tax transfers to the Greater Vancouver Transportation Authority (\$0.12/litre in the GVRD), traffic fine revenue sharing, the hotel tax revenue sharing and recent changes to allow for increased revenue sharing of hotel taxes with designated resort municipalities.

8.2 Accessing Other Taxation Revenue

The municipal public officials interviewed all believe that giving access to other types of taxation revenue is a viable approach to addressing the problem of inadequate municipal revenue sources. Rhoda Howard, however, expressed concern about whether local citizens would accept new taxes. She was also worried about the impact such an initiative would have on the City's efforts to impose road tolls as a measure for transportation demand management and as a source of revenue for transportation. Dale Wall said he believes new municipal taxes are a viable policy, but the initiative will be tricky in terms of sorting out the levels of accountability for the tax. When asked about new municipal taxation revenue sources, Brian Walisser explained that the recommendations presented in the BC Task Force on Community Opportunities Report⁴⁴ should be examined. This is especially the case for the recommendation that, in return for regions undertaking measurable initiatives in support of economic development, they should be entitled to earn incremental revenue from tax sources that grow with the economy.

When asked about which tax they would like to gain, almost all municipal public officials answered in favour of the general sales tax (although some with considerably more certainty than others). There was one exception: Suzanne Fillion, Manager of Budgets and Reporting with the City of Surrey, brought up the corporate income tax as a more feasible alternative. She explains that taxing businesses based on their incomes rather than their property more adequately reflects ability to pay and municipal services used. For example, businesses with higher incomes tend to increase the use of municipal transportation services due to the traffic caused by their employers, customers and their inventory deliveries. Karen Levitt stated that in considering options for municipal revenues, criteria such as ability to pay, relation to benefits received, stability, predictability and cost of administration should be considered. At the provincial level, Dale Wall also pointed to the sales tax as the most practical alternative.

In explaining why the sales tax was preferred, municipal officials indicated that a tax reflecting consumption would be a good source for municipalities to diversify and add to their revenues. Marvin Hunt also indicated that it is preferable to income taxes because "we don't want to motivate people to make less money, we want to motivate them to consume less." Income taxes were also dismissed due to the anticipated high levels of administration costs, especially due to the issue of determining the residential versus workplace tax base. Peter Ladner explained that, in his impression, income taxes are not as directly related to City services used as sales taxes. Access to a sales tax would give municipalities an incentive to stimulate business in the

⁴⁴ Details on the BC Task Force on Community Opportunities are provided in section 5.3.

city. He comments that cities currently have no incentive to attract more conventions. Right now, conventions would create more costs for the City than any direct benefits. Rick Earle also expressed a preference for the sales tax. However, he is concerned about the incentives this could create for municipalities. He brings up Mesa, Arizona, as an example of a municipality that caters to car lots because they generate a lot of local sales tax revenue. He also expressed concern over the stability of the revenue source, since it varies widely over the business cycle. Earle believes having a small share of the PST, such as a 0.5 percent rate, will help provide cities with economic incentives and a new revenue source. At the same time, it isn't a large enough share that cities would be impelled to encourage car lots to make up the difference if the economy turns down.

When asked about their implementation preferences for the sales tax, most municipal officials preferred to have a universal rate for all municipalities, set and collected by the Province. Peter Ladner and Rick Earle brought up the PST review currently being undertaken by the Province and mentioned that it would be a good opportunity for the Province to do a 0.5 percent to 1 percent shift of the tax rate to the municipalities. Earle commented that he would accept the lack of control over the sales tax rate given that a province wide implementation would be easier to administer and would avoid economic issues associated with having a tax rate differential across cities. He remarks that it is not unprecedented to have a tax go to different levels of government once it has been collected. Municipalities are currently doing this with the property tax. Marvin Hunt also believes the Province should set and collect the tax. He emphasizes that he does not want to see municipalities competing with each other over the rate. If we had variable rates, he believes the cities would compete themselves to zero. He explains that accountability could be an issue if the Province set the tax rate. However, he brings up the case of the gas tax, where senior levels of government set the criteria for expenditure of the funds and municipalities have to account for their outlays at year end. Hunt remarks that such a model is transparent, accountable and saves administration costs. At the provincial level, Dale Wall also believes a PST shift to the municipalities is the most practical approach. Having the Province set the rate creates fewer distortions than if it were left to the municipalities, he says. It is hard to say whether a 1 percent sales tax rate differential would make a difference, but individuals may perceive it to be a big enough difference to change their shopping destinations or business locations. However, he remarks that it is difficult to say whether the accountability issue will be addressed. People may still associate the entire tax with the Province. If this is implemented, Wall stresses that we will need to give it a high profile so that people understand that municipalities have taken on part of the responsibility for the PST. Wall also expressed concern over the Province's administrative

complications with a shared PST. One issue arises with the purchase of business inputs and determining how such revenues would be distributed to municipalities.

Ken Bayne, on the other hand, believes municipalities should be the ones to set the tax rate. He explains that municipalities should have to justify their use of any revenue source. He believes the City of Vancouver is up to the task of managing it. He is sceptical of the effect a tax rate differential across municipalities would have on local businesses. He believes the property tax would likely have more of an influence on location decisions than a sales tax. That being said, from an administrative point of view, it would be advantageous for adjoining municipalities to coordinate in setting similar rates.

8.3 Considering Non-Taxation Policy Alternatives

I asked interview participants to comment on whether there are other viable policy alternatives that don't entail access to additional types of taxes. The most common answer was to have the Province drop the school portion of the property tax. This alternative would give municipalities' greater access to property tax revenue. However, it would fail in giving municipalities' access to a more diverse set of sources. Aside from this, Marvin Hunt pointed to the recommendations in the BC Task Force on Community Opportunities Report and brought up one of their recommendations about relieving cities from the cost of fire services. He believes fire services should get funds from the Province because of their role in medical emergencies that are not fire related. He also believes that insurance companies should take on some or all of the costs associated with fire services.

8.4 Implementation Barriers

Municipal officials perceive that the provincial government would be reluctant to give cities access to an area of provincial taxing jurisdiction. Allowing cities access to a sales tax would reduce the Province's flexibility over the rate. In addition, Rick Earle remarked that provinces don't want to collect a tax and then transmit the benefits to the city. Dale Wall also asserts that there is a lack of clear evidence that municipalities need access to additional taxation sources. He believes that municipalities would also need to sort out how they will deal with the administrative complications and the economic distortions associated with this policy alternative. Ken Bayne also believes that municipalities will need to demonstrate that they can manage revenues that come from a less stable source. They would need to devise contingency plans for periods when revenues declined.

Indeed, the readiness of municipal governments to accept responsibility for additional taxes is another implementation barrier. According to Angela Deering, alternative taxation sources were contemplated when the Community Charter was being created. However, local governments agreed that the cost of administration for several small additional taxes or tax schemes outweighed the benefit obtained from the tax. Brian Walisser also stated that municipalities don't want to be responsible for imposing new taxes. They just want access to federal and provincial taxation revenues without the political onus of imposing the taxes.

The political viability with respect to city residents and businesses would also be a challenge. Earle commented that the high business property tax rates have made businesses suspicious of granting municipalities access to other taxes. Levitt explains if the Province could give up a percentage of its sales tax revenues and provide that "tax room" to local governments, it would not be politically difficult to implement since it will not affect the overall level of sales tax paid by consumers.

9 Evaluation of Policy Alternatives

Having discussed policy alternatives with the relevant public officials and policy analysts, I evaluate them according to the relevant criteria in this section. This evaluation takes into account many of the policy implementation outcomes experienced in American cities. The criteria used to evaluate the taxation alternatives are equity, revenue yield, impact on local economic growth, administrative efficiency, accountability and political viability.

9.1 Municipal General Sales Tax

Equity:

- The sales tax is equitable in the sense that it captures the benefits received by non-residents (visitors or commuters) who consume goods and services in the city.
- The tax is regressive; proportionately, it bears more heavily on lower than higher income households. Therefore, it is not well related to ability to pay. Tax base exemptions for selected consumption items helps to address the problem of inequity.
- In terms of equity among residents of different places, local sales tax revenue yields differ among jurisdictions according to the amounts of retail sales activity. Jurisdictions with little retail presence will raise much less revenue. This could exacerbate inequities between wealthy and poor jurisdictions. In the context of the GVRD, one can anticipate that, due to the presence of the Richmond Auto Mall, which has many large car dealers selling to residents of other municipalities, Richmond would generate a disproportionate amount of revenue relative to other cities. Income taxes and property taxes may offer a more geographically uniform distribution of the tax base.⁴⁵ The Province can correct for this by distributing sales tax revenues according to a formula that takes other factors into account (such as population), aside from the origin of the sale.

Revenue Yield:

⁴⁵ Advisory Commission on Intergovernmental Relations (1989).

- Revenue yield can vary substantially depending on the local tax base and on the growth of the economy. Sales tax revenues increase with economic growth, although less so than the income tax because the sales tax has a flat rate versus the progressive rate schedule for income taxes.⁴⁶
- Some reports have indicated that the retail sales tax base has been shrinking, mainly because of the continued shift from a manufacturing to a service based economy. The increase in internet and mail-order purchases has also contributed to this trend.⁴⁷
- Tax base exemptions for a selection of consumption items diminish the revenue yield.

Impact on Economic Growth:

- Sales taxes, more so than property taxes, have a more mobile base. Sales taxes may discourage consumption and encourage the flight of commercial facilities to outside taxing jurisdictions.⁴⁸
- Municipal sales taxes could increase economic growth by encouraging municipalities to promote initiatives that could increase consumerism. This effect will be limited if the Province chooses to distribute the sales tax revenue according to a formula that considers factors other than the jurisdiction of sale.

Administrative Efficiency:

- It will be more administratively efficient for the local government if the provincial government were to administer and collect the tax.
- For chain stores that report their sales tax revenue in their regional offices, it will be difficult to identify where the tax revenue is collected.

Accountability:

- Tax rate setting and collecting at the local level increases the autonomy and accountability of the local government. Citizens will be more aware of how much money the local government is collecting from them. If the Province sets the tax rate, then the municipalities should be accountable to the Province by demonstrating to them how they chose to spend the revenues from this tax.

Political Viability:

⁴⁶ Slack (2004).

⁴⁷ Brunori (2003).

⁴⁸ Advisory Commission on Intergovernmental Relations (1989).

- Allowing cities to set the tax rate will increase their autonomy levels, which will be worrisome for some lobby groups such as the Vancouver Board of Trade and the Business Council of BC, which have opposed past efforts to raise municipal government autonomy in BC.
- As is the case with personal and corporate income taxes, the implementation of sales taxes by local government will prevent the tax from being used more widely by federal and provincial governments. Reduced flexibility is a concern for policymakers in senior levels of government. If the provincial government sets the tax rate, or a cap on the rates that municipalities can apply, this effect will be mitigated since it will still have some control over local tax rates.
- Based on interview results, the sales tax is the most politically viable tax option to provincial and municipal public officials.

9.2 Municipal Personal Income Tax

Equity:

- In terms of equity among residents of different places, local income tax revenue yields differ among jurisdictions. Depending on whether the tax is a wage tax or a payroll tax, jurisdictions with less residential density or employment activity will raise much less revenue. This is especially the case when comparing core cities with surrounding suburbs. Considering the patterns of individuals who commute to the core city for work while living in the suburbs, it is predictable that a wage tax would favour the suburbs while a payroll tax would favour the core city.
- A wage or payroll tax would tax only earned income. Therefore, the tax does not treat salaried workers equitably with individuals who gain income from other means—such as self-employment, investments, or pensions.
- Progressive income taxes are considered to be more appropriate means to pay for social services because they are more closely related to ability to pay than property taxes and sales taxes.⁴⁹
- Unlike sales taxes, income taxes are not as directly linked with benefits received from consumption in the city by visitors. However, an income tax based on work location would get commuters to contribute to the costs of municipal service delivery.

⁴⁹ Slack (2004).

Revenue Yield:

- The revenue yield varies with the state of the economy. When incomes fall, revenues fall more than proportionally. Therefore, the revenue is not as stable and predictable as property tax revenue. However, income tax revenues grow more quickly than sales or property tax revenue as income rises.⁵⁰

Impact on Economic Growth:

- Income taxpayers are mobile and can avoid the tax by working or moving to a neighbouring jurisdiction. This problem can be mitigated by setting a universal provincial rate, which would be implemented through the piggyback income tax.
- As was the case in several of the U.S. cities studied in the previous section, a municipal income tax can negatively effect employment levels, retail sales and housing values.
- Municipal income taxes could increase economic growth by encouraging cities to promote initiatives that could increase employment levels (in the case of a payroll tax) or high density residential housing (in the case of a wage tax).

Administrative Efficiency:

- The locally designed progressive income tax is the most burdensome tax, administratively speaking. This is because the local government must measure both earned and unearned income of individuals and operate a collection and enforcement system. Collection of the piggyback tax does not require any local administrative efforts since the tax collection is handled by other levels of government. Locally administered wage and payroll taxes require local administrative bodies to collect the tax, but they are much less administratively complex than progressive local income taxes.
- An income tax imposed at the workplace location of the individual (such as a payroll tax) is more administratively feasible than an income tax imposed at the residential location of the individual (such as the wage tax). This is because, in the case of a payroll tax, the revenues would be collected from the employer.
- If income tax rates are not universally set across localities, the variance can increase administrative costs when employers have workers in more than one locality.

Accountability:

⁵⁰ Brunori (2003).

- All types of income taxes are highly visible. Visibility gives incentive for citizens to hold their governments accountable for how money is being spent.
- Tax rate setting and collecting at the local level increases the autonomy and accountability of the local government. Citizens will be more aware of how much money the local government is collecting from them.
- If the income tax is imposed at the individual's workplace, then the municipality will need to be accountable to both its residents and to individuals who commute to the municipality for work. This may negatively affect accountability levels because individuals who commute to the municipality for work are not allowed to vote in the civic elections of that municipality.

Political Viability:

- Some reports have shown that citizens have a strong political bias against the income tax, more so than the sales tax.⁵¹
- Allowing cities to set the tax rate will increase their autonomy levels, which will be worrisome for some lobby groups such as the Vancouver Board of Trade and the Business Council of BC, which have opposed past efforts to raise municipal government autonomy in BC.⁵²
- As is the case with sales and corporate income taxes, the implementation of personal income taxes by local government will prevent the tax from being used more widely by federal and provincial governments. Reduced flexibility is a concern for policymakers in senior levels of government. By using a piggyback tax, this effect will be mitigated since senior levels of government will still have flexibility and control over the local tax rate.

9.3 Municipal Corporate Income Tax

Equity:

- Corporate income taxes can reflect benefits received from the city, albeit in a very rough manner. For example, higher corporate incomes are often associated with higher transportation needs for customers, employees and inventory deliveries.
- Corporate income taxes are associated with ability to pay.

⁵¹ Ibid.

⁵² Vancouver Board of Trade (2002).

- Since businesses are already considered to be overtaxed in property taxation, they may claim an additional tax on businesses is unfair towards them. However, this new tax could be utilized, in part, to reduce the high rates of business property taxes in BC.
- If a corporate income tax were applied by municipalities without a companion personal income tax, this might be deemed unfair treatment of incorporated versus unincorporated businesses.

Revenue Yield:

- Corporate tax revenues can be high, but also extremely volatile over the business cycle.⁵³

Impact on Economic Growth:

- Corporate income taxes are imposed on a very mobile base. Therefore, the tax can deter businesses from locating within the city. This problem can be mitigated by setting a universal provincial rate. However, due to the high mobility of the tax base, the total provincial corporate tax rate needs to be competitive with the rates in other provinces and countries.

Administrative Efficiency:

- Corporate taxes are difficult to administer in terms of allocating the income, and associated tax liability, across multiple jurisdictions. This is especially difficult when corporations conduct business in multiple jurisdictions across the province.

Accountability:

- Since the Canada Revenue Agency collects the provincial corporate income tax, it is unlikely the cities will be able administer the tax themselves. Therefore, local accountability will not be enhanced.

Political Viability:

- Businesses already believe they are overtaxed by municipal property taxes.⁵⁴ They would likely resist the imposition of additional taxes aimed at businesses. Therefore, the imposition of a corporate income tax will only be viable if it is accompanied with a shift away from the business property tax.

⁵³ Slack (2004).

⁵⁴ Vancouver Board of Trade (2002).

- As is the case with sales and income taxes, the implementation of corporate taxes by local government will compete with use of this tax base by federal and provincial governments. Reduced flexibility is a concern for policymakers in senior levels of government.
- Since the tax is collected by the federal government, it may be difficult for the Province and the federal government to cooperate in including a local rate.

9.4 The Status Quo – Property Tax as the Main Tax

Equity:

- Property taxes are not closely related to benefits received and ability to pay of individual property owners.
- Currently, businesses are complaining that the non-residential class rate is unfairly high.

Revenue Yield:

- Property taxes provide predictable and stable revenue.
- Property tax revenues are not directly linked to local economic growth. Therefore, they tend to respond slowly to changes in economic conditions.

Impact on Economic Growth:

- High non-residential property tax rates may play a role in deterring businesses from locating or expanding in the city.

Administrative Efficiency:

- Since this is the status quo option, little administrative costs are associated with it. Even if municipalities supplemented the property tax with another substantial source of tax revenues, the administrative apparatus and expense of the property tax would still remain.

Accountability:

- Since the city raises property taxes for seven other authorities, citizens do not see the clear link between the taxes they are paying and the organizations who spend their money. However, on the taxpayer's annual notice, these other levies are separately itemized, so that potentially they can distinguish among the various taxes.

Political Viability:

- Businesses are currently protesting against the high non-residential property tax rates.

- The property tax is a highly visible tax. This negatively affects its acceptance to the public.
- The property tax is a fixed cost that businesses and residents must pay regardless of their income levels. This factor also adversely affects its political acceptance.

10 Policy Recommendations

Based on information gathered from interview participants, it is clear that a sales tax is the most preferred option. Almost every municipal public official has pointed to the sales tax as the best alternative. In most cases, the personal and corporate income taxes were not recommended and were in fact dismissed on the grounds of administrative difficulties and the potential impact on employment. Corporate income taxes are indeed difficult to administer and are not believed to be politically viable within the City of Vancouver because they consist of another tax on businesses. As mentioned by Ken Bayne during his interview, the City of Vancouver has had the option of using the business levy as a tax but has always opted against this alternative. Businesses are already actively complaining about being overtaxed by local governments. The income tax would also be administratively problematic in terms of keeping track of the residence and workplace jurisdiction of the tax base.

The sales tax is the tax most linked with the benefits from consumption of service and goods in the city. It also provides municipalities with a source of income that will grow with the economy. The tax is not closely tied to ability to pay, but the system used by the provincial government to exempt select goods and services helps to address this problem; moreover, the Province offers a refundable sales tax credit for individuals and households at low incomes. Therefore, operating a municipal sales tax that is harmonized with the PST and applied to the same goods and services is the most practical and equitable approach.

Municipalities would be more accountable if they had the authority to set their own tax rates. However, such an increase in municipal financial autonomy and flexibility may be more difficult for the Province and for local businesses to accept. Even municipal decision makers are having difficulty accepting this responsibility. If access to the sales tax were granted, most City officials expressed a strong preference in having the Province set a universal rate, by shifting 0.5 to one percent of the PST over to municipalities. A one percent shift of the PST to municipalities would cost the Province \$625 million.⁵⁵

⁵⁵ This figure is presented in section 6.1 of this report.

The only public official in favour of having the City set the tax rate is Ken Bayne from the City of Vancouver. If the City of Vancouver considers itself to be willing to have responsibility over the tax rate, it should be granted additional authority to do so under the Vancouver Charter. A low universal sales tax rate imposed by the Province would help BC cities address their funding challenges. At the same time, municipalities wanting to have additional taxation revenues should be permitted an additional range that would also be collected by the Province, but set by the municipality. For political feasibility reasons, the allowable range should be limited by the Province. This will make sales tax access more acceptable to the Province and to local businesses. The State of California provides a good framework for this: The State applies a universal rate throughout California (with a universal portion going to the local jurisdiction of sale) while, at the same time, permitting an additional allowable range of sales taxation for municipalities to levy.

The implementation of a low universal rate would help municipalities avoid the problems associated with inter-jurisdictional competition. However, under this implementation, cities that rely on the universal rate collected and set by the Province would not be required to justify why they need these funds. The revenue source would effectively be an unconditional grant from the Province. Taking this into account, the universal rate would have to be low enough to encourage municipalities to coordinate themselves in applying an increment to the rate. Therefore, to raise any substantial amount of funds through this tax, municipalities would have to make themselves accountable to their citizens in order to justify an increase in local taxation.

Letting the Province collect the tax revenues would substantially increase administrative efficiency by avoiding the duplication of services at different governmental levels. At the same time, allowing municipalities to set the tax rate will make municipalities accountable for this revenue source. Slack (2004) concurs by stating that “local autonomy and accountability are achieved by cities setting their own tax rates to meet their expenditure needs” (p. 18). Publicizing this initiative would help to raise awareness and make individuals understand that the City is setting the rate of tax and should be held accountable for its expenditure.

In distributing the sales tax revenues to the municipalities, there should be a clear linkage to the individual city’s economic activity. Therefore, revenues should be remitted primarily based on the point of sale. However, the remittance formula should also, to a lesser degree, consider the population of the jurisdiction so as not to exacerbate inequalities across jurisdictions that have more retail sales activity and, hence, more sales tax revenues.

As mentioned in the evaluation section, sales taxes can discourage consumption and encourage the flight of commercial facilities to outside taxing jurisdictions. Another concern is the impact of a sales tax on municipal land use incentives by encouraging land allocation to retail sales. Mitigating such consequences would require municipal officials to maintain a low rate and a low inter-municipal rate differential.

With the introduction of a municipal component to the sales tax, the property tax would still remain the main tax source for municipalities. However, it would no longer be the only substantial tax source. Access to a sales tax will present municipal officials with the flexibility to lower the property tax rate while at the same time meet increasing service demands.

Giving municipalities' access to a sales tax can be a powerful first step in addressing municipal fiscal challenges. However, in the long run, a case can be made for granting cities access to an even more diverse set of taxes, which would include a local personal and corporate income tax. For now, public officials report that they prefer taxing sales over income. Such preferences and priorities may change over the years. In addition, as explained in my analysis, the sales tax has a somewhat volatile revenue yield. Having access to a more diverse set of taxes can help mitigate this problem and give cities more flexibility to address their fiscal challenges. If access to corporate and personal income taxes were granted, I have the following recommendations:

- A corporate income tax should be adopted only if it is accompanied with a decrease in business property taxes. Businesses are already complaining about bearing high municipal taxes. Therefore, new business taxes should be imposed only if they relieve some of the pressure from other types of business taxes. Implementing a local corporate income tax will also make local business taxes more equitable since the corporate income tax is more closely related to ability to pay and municipal service use as opposed to the property tax.
- A personal income tax should be implemented in the form of a progressive income tax imposed on the location of work. This means that individuals who commute to the municipality for work will financially contribute to municipal service provision. The use of progressive rates will make the tax more equitable since it will take both earned and unearned income into account. It will also be more administratively efficient if it is harmonized with the provincial income tax and collected by the Province.

One of the largest implementation barriers identified by interviewers is the acceptance by businesses to allow municipalities to have additional taxation powers. A strong business case can be made to increase the appeal of the policy option to businesses. TD Bank Financial Group and the Conference Board of Canada, both organizations that have strong credibility in the corporate community, have released reports indicating that the financial health of cities play a strong role in driving the local and national economy.⁵⁶ Also, giving cities access to a sales tax will reward cities with additional revenues for encouraging regional economic growth. Knowing that municipalities will have enhanced incentives to promote local economic growth can play a powerful role in increasing the appeal of the tax to local businesses.

To summarize, my recommendations involve a low universal sales tax rate that is set and collected by the Province in conjunction with the PST and remitted to municipalities. The remittance formula should be based on the locality of sale and, to a lesser degree, the population of the municipality. In addition to this, the Community Charter and the Vancouver Charter should be amended to allow municipalities to increase the sales tax rate within a specified range. Any such supplemental municipal sales taxes should also be collected by the Province to promote administrative efficiency and should be remitted to the municipality.

⁵⁶ TD Bank Financial Group (2002) and Conference Board of Canada (2006).

11 Conclusion

For years, the property tax has provided stable and predictable revenues to municipal governments. Lately, Vancouver and surrounding cities have reported numerous problems in relying on this tax to meet the rising demands for municipal services. Affordable housing is a current leading example of such a service. Interview participants have also identified problems obtaining funds for community service organizations and the maintenance of their water and transportation infrastructure. At the same time, they are facing growing pressure from businesses to lower the property tax rate for non-residential land uses. There is also a concern that cities should be diversifying their revenue sources in order to balance their policy and land use incentives. Access to additional types of tax revenue would help municipal governments gain from local economic growth and would reward them for supporting local economic development.

I conclude that the sales tax offers the most viable additional tax option for cities. I recommend a low universal sales tax rate that is set and collected by the Province in conjunction with the PST and remitted to municipalities. Additionally, municipalities should be given the flexibility and autonomy to increase the sales tax rate within a specified range. Access to a personal and corporate income tax would also improve the cities' access to a diverse range of revenue tools. Such access should be considered in the long run – after municipalities have developed experience with the sales tax.

Using a greater variety of taxes can make the tax structure more equitable by relying on tax bases related to the spending and earning of households and businesses. A greater variety of revenue sources can also improve municipal incentives for balanced zoning decisions. Therefore, if municipalities are able to raise revenues through income, property and sales taxes, they will be less likely to favour specific zoning types for revenue raising reasons. The income tax, however, is much more burdensome administratively, especially with respect to determining the residential versus workplace tax base.

Further research should consider other policy alternatives that do not involve access to additional taxes. The one most commonly raised by interview participants was for the BC government to vacate or reduce its reliance on the “school” portion of the property tax (which in

fact flows into provincial general revenues). In 2006, the Province of BC collected \$1.73 billion from its portion of the property tax.⁵⁷ This is more than two-thirds the amount that BC municipalities collected from the property tax in total during that year, \$2.5 billion. Having the Province reduce its share of the property tax will provide municipalities with additional tax room, allowing them to draw more revenues from the property tax. However, it will not help municipalities in diversifying municipal revenue sources and, consequently, would accomplish little in increasing the efficiency and fairness of municipal service and infrastructure financing.

⁵⁷ British Columbia Ministry of Finance (2006).

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