

# Big Hit on GTA Middle-Class Home Buyers with the Ontario Budget's HST Proposals

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# **Big Hit on GTA Middle-Class Home Buyers with the Ontario Budget's HST Proposals**

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## EXECUTIVE SUMMARY

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This paper is a response to the Harmonized Sales Tax (HST) proposals contained in the 2009 *Ontario Budget* relating to the tax treatment of new housing and contractor renovations. It deals with proposals for the taxation of new ownership housing. The proposed taxation of new rental housing and contractor renovations will be the subject of a separate paper I am preparing.<sup>1</sup>

In short, the \$400,000 price threshold established by the provincial government generates a net provincial tax increase of \$800 million (\$1.8 billion including renovations) on new home buyers in Ontario, with \$575 million of the \$800 million imposed on new home buyers in the Greater Toronto Area (GTA).

The provincial threshold of \$400,000 captures middle-class households and could threaten as many as 21,200 jobs should housing starts fall by up to 15 per cent as a result of the tax treatment on new homes over \$400,000.

## RECOMMENDATIONS

The following recommendations for changes to the new housing proposals contained in the March Ontario Budget are presented in order to minimize negative ramifications on new home buyers, the housing market and the economy at large from the application of the HST in Ontario.

For new ownership housing – as recommended in my previous paper *New Housing is Different: Implications for Sales Tax Harmonization on New Home Buyers in Ontario*<sup>2</sup> - provide the same rebate to all homes regardless of price level – establishing a neutral tax revenue treatment for new housing.

If this option is not acceptable to the provincial government, in an effort to improve the tax treatment of new housing in the proposed HST structure, it is recommended that on the incremental value above \$400,000 a progressive tax structure be applied – similar to the structure established by both the provincial Land Transfer Tax and the Income Tax.

<sup>1</sup> I am also preparing a paper that examines the theoretical basis for treating new housing and contractor renovations differently from household expenditures on goods and services and the tax treatment of new housing and contractor renovations in other jurisdictions under a value-added tax structure comparable to the proposed HST.

<sup>2</sup> Frank A. Clayton, *New Housing is Different: Implications for Sales Tax Harmonization on New Home Buyers in Ontario*, March 2009, prepared for BILD before the March 26<sup>th</sup> budget.

Along with improving the tax treatment of new housing on the Ontario portion of the HST, it is equally important that the federal government improve the GST treatment of new housing and immediately raise the GST thresholds to reflect the inflationary increases in new home prices since 1991.

## **SUBSTANTIAL NEW TAXES ON NEW HOUSING IN ONTARIO**

The Budget's HST proposals will result in a large increase in sales tax revenues to the province from new ownership housing and renovations. I estimate that in the absence of the adverse economic consequences mentioned below, the province would collect some \$2.9 billion in taxes annually from the HST, an increase of approximately \$1.8 billion over the \$1.1 billion now collected under the PST from new ownership housing and contractors' renovations alone.

Additional HST taxes will be collected from new rental housing, taxing of closing costs on new and existing homes, and the additional taxes levied on the inputs for the owners of rental properties.

If the tax treatment of new housing is not improved, it will ultimately result in less new residential construction, less contractor renovation spending and a shift to renovations being done through the underground economy. As a result, the tax revenues the province and the federal government are currently collecting under income taxes and the federal GST will be diminished.

The tax treatment of new housing under the HST runs counter to a number of key provincial public policy goals, including the Province's *Growth Plan for the Greater Golden Horseshoe*.

## **NEW OWNERSHIP HOUSING – UNDERSTANDING THE PROPOSED TAX STRUCTURE AND THE GTA IMPACT**

The HST proposes to tax new ownership housing priced under \$400,000 at 2% rising quickly to 8% for homes of \$500,000 and over as illustrated by:

- HST on new \$400,000 home = \$8,000; rising to
- HST on new \$500,000 home = \$40,000.

The tax rate on the \$100,000 price difference between these homes is a huge 32% (\$32,000/ \$100,000). This extraordinarily large increase in taxes will undermine the opportunity for middle-income Ontarians to purchase a new home, erode the competitiveness of new homes versus the large stock of existing homes, reduce

the volume of new housing built and cause buyers to move away from urban centres to obtain less expensive housing that escapes the burden of the new tax.

The impacts will disproportionately hit new housing in the Greater Toronto Area because of its higher price level and middle income households:

- GTA buyers will be hit with an estimated 72% of the province-wide increase in sales taxes on new ownership housing resulting from the Province's HST proposals; and
- New homes over \$400,000 are not exclusively owned by the very wealthy. Among owners of newly-built homes in the GTA that are valued at \$400,000 and above, a significant number of households are classified economically as "middle class".

## **NEW OWNERSHIP HOUSING – OPTIONS TO IMPROVE THE TAX TREATMENT OF NEW OWNERSHIP HOUSING UNDER THE HST**

I have formulated three options to the Budget proposals:

- **The Neutral Tax Revenue option** - establishing a neutral tax revenue treatment for new housing by applying a 2% tax rate against all new housing regardless of price, the same effective tax rate as under the existing PST.
- **The Progressive Tax Rate option** – tax the first \$400,000 of value at 2% and apply a progressive tax structure against the portion of the value above \$400,000 - similar to the structure established by both the provincial Land Transfer Tax and the Income Tax.
- **Updated GST Price Threshold option** – The federal government should immediately update the 1991 GST rebate price thresholds from \$350,000 and \$450,000 for home inflation since 1991 to \$550,000 and \$700,000, with the Ontario government harmonizing to these new federal thresholds, along with regularly updating the thresholds for inflation in the future.

The first option would be preferred in terms of ensuring no negative impacts on new housing or home buyers. The second option would eliminate the sharp rise in the marginal tax rate for homes priced greater than \$400,000, thereby moderating the adverse housing and economic repercussions flowing from this anomalous feature of the proposed HST.

The third option, although a federal initiative, would improve the thresholds for the overall treatment of new housing under the proposed HST to reflect the current new housing market reality. However it would still have negative ramifications for the housing market.

## TRANSITION PROVISIONS

The introduction of any new tax or major alteration of the function of a present tax is sure to disrupt the normal operation of the housing market. The HST is scheduled to take effect on July 1, 2010 and is likely to have a profound negative impact on new homes in the pipeline without proper transition rules that recognize the lengthy investment, planning, development, sales and marketing, and the building cycle inherent in residential construction, whether high-rise or low-rise.

The transition provisions need to be looked at from a buyer's standpoint in terms of the individual agreements of purchase and sale, along with protecting the project viability by understanding the economics of the entire project which go all the way back to the investment in the land and may take years to realize.

I take it as a given that there will be no retroactive taxation as a result of the HST and put forward the following scenarios relating to purchasers as well as projects, to ensure that outcome:

- Exemption from any HST increase for new homes purchased prior to the budget (before March 26, 2009) that close after the implementation date (July 1, 2010) of the HST;
- Exemption from any HST increase for new homes purchased after the budget (March 26, 2009), but before the scheduled implementation date of the HST (July 1, 2010), that close after the implementation date; and
- Exemption from any HST increase for projects registered with Tarion prior to the implementation date of the HST (July 1, 2010) with units closing after the implementation date of the tax.

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This paper is a sequel to another paper I recently prepared entitled *New Housing is Different: Implications for Sales Tax Harmonization on New Home Buyers in Ontario* (March 9, 2009). This earlier paper was prepared prior to the tabling of the 2009 *Ontario Budget* on March 26<sup>th</sup>. A summary of its findings is included in Appendix A.

This current paper revisits the Harmonized Sales Tax (HST) issue in response to the proposed tax treatment of new ownership housing contained in the 2009 *Ontario Budget*. It also discusses the importance of transitional provisions that treat new home buyers and homebuilders fairly and that minimize market disruption from the conversion to the new Harmonized Sales Tax (HST) from the existing Provincial Sales Tax (PST).

I am preparing another paper that deals with the HST proposals on new rental housing and contractor renovations.<sup>3</sup>

## 1. SUMMARY OF PROVINCE'S HOUSING HST PROPOSALS

The 2009 *Ontario Budget* proposes to combine the province's PST with the federal GST to create a federally-administered single sales tax (the province's share of the new tax is referred to as the HST in this paper). The new tax is scheduled to start July 1, 2010.

### 1.1 New Ownership Housing

The 2009 *Ontario Budget* proposes to tax new ownership housing at the full HST tax rate of 8%, the same rate as the existing PST, with the exception of new homes qualifying for a full or partial New Housing Rebate:

- **For new homes priced under \$400,000:** a rebate of 75% (6 percentage points) resulting in an effective tax rate of 2%<sup>4</sup>, matching the existing embedded PST currently levied only on building materials;
- **For new homes priced between \$400,000 and \$500,000:** the rebate declines sharply from 75% to nil with the result that the effective tax

<sup>3</sup> I am also preparing a paper that examines the theoretical basis for treating new housing and contractor renovations differently from household expenditures on goods and services and the tax treatment of new housing and contractor renovations in other jurisdictions under a value-added tax structure comparable to the proposed HST.

<sup>4</sup> The term "effective tax rate" refers to the amount of tax levied on a new home as a percentage of the price of the home.

rate rises from 2% to 8% on the full price of the homes in this price range, not just the increment in price above \$400,000; and

- **New homes priced above \$500,000:** these homes would receive no rebate, so the homes are taxed at an effective rate of 8% on the full price.

There is no mention of adjusting the \$400,000 and \$500,000 price thresholds upwards for future housing price inflation, so that over time, with static price thresholds, fewer and fewer homes will qualify for the rebate.

## 1.2 Transitional Provisions

The Budget does not provide information on how the transition between the existing PST and the new HST will be carried out for new housing. Badly chosen rules could have undesirable harsh repercussions on the buyers and sellers of new homes over the period between now and July 1, 2010 and cause unwanted disruption to the new housing market resulting in new residential construction and ancillary job losses.

## 1.3 Stifling Increase in Taxes on Housing with the Proposed HST

The province's proposals entail large increases in the rate of taxes on the housing sector from 2% rising to 8% for new ownership homes priced at over \$400,000.

These increases are magnified in the case of new housing because new housing is an investment good providing a stream of consumption for 50 to 75 years or more into the future. The proposed tax is a tax on current and all future housing services.

Under its proposals, the province will levy some \$1.8 billion in sales tax revenues over and above the estimated \$1.1 billion in revenues now collected with the existing PST even with the exemption it has proposed with respect to new ownership homes prices under \$400,000 including<sup>5</sup>:

- An estimated increase of \$800 million in additional taxes on new ownership housing not eligible for the New Housing Rebate; and

<sup>5</sup> These revenue estimates do not allow for any reduction in the volume of new construction or contractor renovations due to the additional tax levies, which would reduce not only sales tax revenues to the province and the federal government but other tax revenues such as the income tax.

- An additional \$990 million of taxes levied on residential renovations undertaken by contractors (there would not be any tax increase on do-it-yourself renovations).

Figure 1

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**Estimated Additional Sales Taxes Imposed on New Ownership Housing and Contractor Renovations Under the Ontario HST**

	Existing PST	Proposed HST	Increase in Taxes Imposed
	<i>Millions</i>		
New Ownership Housing	\$ 601	\$ 1,399	\$ 798
Contractor Renovations	<u>\$ 477</u>	<u>\$ 1,468</u>	<u>\$ 991</u>
Total	\$ 1,078	\$ 2,867	\$ 1,789

Source: Altus Group Economic Consulting

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The province's actual tax levies under the new HST from the housing sector will be even higher than indicated in Figure 1. The revenue estimates in Figure 1 exclude:

- Added revenues from new rental construction;
- Additional sales taxes on closing costs of new and existing homes (legal fees, mortgage insurance premiums, etc) due to the broadening of the sales tax base; and
- Added taxes paid by rental housing providers (owners of rental properties) due to the broadening of the tax base combined with exempting rents from the tax – rental housing providers will have to pay HST on their input costs but will not get input credits.

#### 1.4 The New HST Fails to Consider the Land Transfer Tax is Already a Tax on Home Sales

In realty, new homes are not only taxed at the present time under the existing PST, but under the long-standing land transfer tax of the province as well. The rate of tax under the land transfer tax reaches 2% for the portion of value above \$400,000. For new homes in the City of Toronto there is a second land transfer tax which was introduced last year. Here the rate of tax reaches 1.5% for the portion of sales price above \$400,000.

The analysis in this report does not explicitly consider these land transfer taxes but they are a sales tax over and above the tax proposed by the

province under the HST, e.g., there is double taxation by the province and triple taxation in the City of Toronto on the sales of new homes.

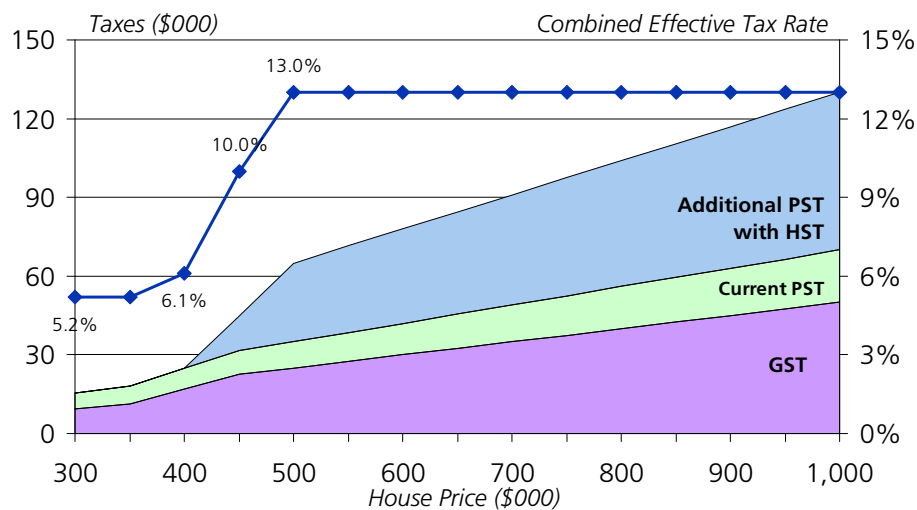
## 2. NEW OWNERSHIP HOUSING

### 2.1 An Aberrant Leap in the Effective Tax Rate on New Homes Priced Between \$400,000 and \$500,000

Figure 2 shows the net new revenues to the province under the HST rise from nil for houses priced at \$400,000 to \$30,000 for houses priced at \$500,000 (blue coloured area at top). This results from a marked rise in the effective tax rate (taxes as percent of sale price) from 2%, the rate embedded in the existing PST, to 8% over a \$100,000 price bracket for new housing.

Figure 2

#### Total Federal and Provincial Sales Taxes on New Housing Under Ontario HST Proposal



Source: Altus Group Economic Consulting

The “marginal tax rate” on buying a \$500,000 home rather than a \$400,000 home under the proposed provincial tax is a whopping 32% (\$32,000/\$100,000).

The magnitude of the additional taxes on new housing proposed by the province between a house priced at \$400,000 and a house priced at \$500,000 is exorbitant in relation to the combined burden of the present PST and the federal GST. It also fails to consider that onerous municipal-imposed charges on new housing are already in place in the province and that new housing is

more expensive in Ontario than in most provinces.<sup>6</sup> Within the province, new housing in the GTA is more expensive than in most other areas.

## 2.2 GTA Hit Hard by the Additional Tax on New Housing

Figure 3 shows the brunt of the tax will be borne by home buyers living in the GTA who will be bearing \$575 million of the additional \$800 million in provincial sales tax. GTA buyers will be hit with an estimated 72% of the province-wide increase in sales taxes on new ownership housing resulting from the Province's HST proposals.

Figure 3

### Additional Provincial Sales Tax Revenue on New Ownership Housing Under the Proposed HST, Percent of Total Increase in Province

	Type of Housing			Type of Housing		
	Single-Detached	All Other	Total	Single-Detached	All Other	Total
	\$Million			Percent		
GTA						
City of Toronto	\$ 79	\$ 55	\$ 134	9.9%	6.9%	16.8%
905 Areas	\$ 398	\$ 42	\$ 440	49.9%	5.3%	55.2%
Total	\$ 477	\$ 98	\$ 575	59.8%	12.3%	72.0%
Rest of Ontario	\$ 205	\$ 18	\$ 223	25.7%	2.3%	28.0%
TOTAL ONTARIO	\$ 682	\$ 116	\$ 798	85.4%	14.6%	100.0%

Source: Altus Group Economic Consulting based on 2006 Census and Statistics Canada data

New single-detached housing will bear approximately 85% of the estimated additional tax burden on new ownership housing under the Province's HST proposals net of the New Housing Rebate (an estimated \$800 million dollars).<sup>7</sup> This is considerably higher than the share of new housing built in recent years that consisted of single-detached houses (about 64%).

<sup>6</sup> Appendix B describes the regimes of government-imposed costs (all levels of government) on new housing across Canada which demonstrates that new housing in Ontario, along with B.C., is already subjected to the most onerous government-imposed costs in aggregate, in the absence of the massive increase in HST taxes being proposed in Ontario for homes priced above \$400,000. The proposed HST will push Ontario into a category by itself in terms of the quantum of costs imposed on new housing within its borders.

<sup>7</sup> This finding is based on an examination of the price range of new homes absorbed in the first half of the decade with the prices updated to early 2009 values. These data likely understate the percentage of new dwellings other than single-detached homes, particularly in the City of Toronto, with more luxurious condominium apartment projects being marketed in recent times.

### 2.3 Significant Numbers of Middle-Income Households Buy Homes Priced at \$400,000 and Over

New homes over \$400,000 are not exclusively owned by very wealthy Ontarians. Among owners of newly-built homes in Ontario that are valued at \$400,000 and above, a significant number of households are classified economically as “middle class”:

- Over one-quarter of owners of newly-built homes in Ontario and the GTA that are valued at \$400,000-\$499,999 have total household incomes of \$70,000 or less as do over one-fifth of buyers of homes priced at \$500,000 or more (Figure 4).
- About half of owners of newly-built homes in Ontario and the GTA that are valued at \$400,000-\$499,000 have total incomes below \$100,000 as do more than a third of the buyers of homes priced at \$500,000 or above.

Figure 4

#### Income of Households Buying New Homes Priced \$400,000 and Over, Ontario and GTA, 2006\*

Household Income	Ontario		GTA	
	\$400,000-\$499,000	\$500,000 and Over	\$400,000-\$499,000	\$500,000 and Over
	<i>Percent Distribution</i>			
Under \$70,000	26.6	22.6	29.2	23.7
\$70,000 to \$99,999	21.7	14.9	22.4	15.2
\$100,000 to \$124,999	17.5	13.2	18.0	13.3
\$125,000 to \$149,999	13.1	10.7	12.5	10.6
\$150,000 and over	21.1	38.6	17.9	37.2
Total	100.0	100.0	100.0	100.0

\* New homes approximated by dwellings constructed over the 2001-2006 period.

Source: Altus Group Economic Consulting based on 2006 Census custom tabulations

Households with incomes in these ranges (below \$100,000) are solidly middle-class, and are generally below most of the other “surtax” categories considered in other taxation programs. Households in these categories with two incomes are generally well below the highest tax brackets in Ontario. They do not qualify for Ontario’s income tax “surtax” and would qualify for the province’s proposed \$1,000 transition rebate for consumer services subject to the new HST. In light of this, the additional tax on new ownership housing through the HST appears to be treating these middle-income, middle-class families in a contradictory fashion from a public policy perspective.

## 2.4 Negative Economic Impacts of the Province's HST Proposals for New Ownership Housing

The housing industry is an important generator of jobs. It is estimated that new home and renovation construction activity provides about 325,000 person years of employment in construction and related industries. The proposed HST on new housing (and renovations) will compromise the ability of the housing industry to continue to provide this large number of jobs.

Figure 5 illustrates the disproportionate impact of the HST on GTA new home buyers. It is estimated that almost 44% of new homes sold in the GTA are priced \$400,000 or higher, about double the proportion in the rest of the province.

Figure 5

	City of	Rest of		Rest of	
	Toronto	GTA	GTA	Ontario	Ontario
<i>Percent Distribution</i>					
<b>Single-Detached</b>					
Under \$400,000	4.9	21.8	18.1	57.0	35.7
\$400,000-\$499,999	4.1	18.8	15.6	10.3	13.2
\$500,000 and over	11.0	22.3	19.8	10.1	15.4
Total	19.9	62.9	53.5	77.4	64.3
<b>All Other Dwelling Types</b>					
Under \$400,000	61.5	31.5	38.1	20.8	30.3
\$400,000-\$499,999	8.6	3.6	4.7	0.9	3.0
\$500,000 and over	10.0	2.0	3.7	0.9	2.4
Total	80.1	37.1	46.5	22.6	35.7
<b>All Dwelling Types</b>					
Under \$400,000	66.4	53.4	56.2	77.8	66.0
\$400,000-\$499,999	12.7	22.4	20.3	11.2	16.2
\$500,000 and over	20.9	24.2	23.5	11.0	17.8
Total	100.0	100.0	100.0	100.0	100.0

Note: Distribution of new housing absorption 2001-2006 with prices updated to early 2009.  
Source: Altus Group Economic Consulting based on 2006 Census custom tabulations

## 2.5 Fewer New Ownership Housing Units Built Because of the Higher Taxes on Homes Priced \$400,000 or More

The sharp rise in the effective tax rate from 2% to 8% for new homes priced below \$400,000 and those priced above \$500,000 cannot avoid having negative repercussions on the demand for new homes in the \$400,000 up to \$800,000 range and even higher ranges. Resale homes which are not taxed

will be a more attractive alternative so demand will shift from new to resale homes.

Even a 10 to 15% reduction in the demand for new homes because of the new tax translates into some 7,400 to 11,100 fewer new housing units being built annually in the province. This drop in new housing construction would directly impact new housing centred in the GTA.

## **2.6 Reduced New Housing Construction Translates into Less Economic Activity and Fewer Jobs in Construction and Ancillary Sectors**

A 10% to 15% decline in the level of new residential construction will have significant repercussions on employment and other taxes levied by the province (e.g., income tax):

- 14,100 to 21,200 fewer person years of employment in the construction industry and industries providing goods and services to it;
- \$0.72 to \$1.1 billion dollars in lost wages; and
- \$50 to \$75 million dollars in lost provincial income taxes.

## **2.7 Encouraging New Home Buyers to Move Further Out to Find Less Expensive Homes**

New homes typically are less expensive in locations at or beyond the suburban fringe of larger urban centres like Toronto or Ottawa. Home buyers who had intended to buy a \$500,000 home in, say, Markham with the HST proposal will have an incentive to move further out and buy the same home for \$400,000 in places like Georgina or East Gwillimbury. The obvious results are more lower density outlying communities, generating longer commutes and creating larger environmental footprints, all of which work against key provincial public policy and planning initiatives like the province's *Growth Plan for the Greater Golden Horseshoe*.

## **3. OPTIONS TO THE PROVINCE'S HST PROPOSALS ON NEW OWNERSHIP HOUSING**

Clearly, the current HST proposals at the provincial level and/or the provisions of the GST levied on the new housing sector need to be improved to reduce the sizeable harmful impacts from the new HST on new housing.



### 3.1 Neutral Tax Revenue Option - Tax All New Ownership Housing at 2%

The most obvious option from an economic impact concern would be for the province to adopt a neutral tax revenue HST system that would not increase the tax burden on new housing from the taxes under the existing PST.

This would be achieved by keeping the sales tax rate at the existing 2% for all new ownership housing, that is, by extending the province's proposed rebate of 6 percentage points for new ownership housing priced under \$400,000 to all new housing regardless of price range, as recommended in my March 2009 report (see Conclusions in Appendix A).

If the province is not prepared to consider the extension of its New Housing Rebate to all new homes, other options can help mitigate the negative impacts of the HST proposals in the Budget. Two possible options are outlined below.

### 3.2 The Progressive Tax Rate Option

Under the Progressive Tax Rate option, new housing priced under \$400,000 would continue to be taxed at 2% (after the rebate) with a progressive tax structure (rising to 8%) applied to the incremental value of homes priced above \$400,000 (see Figure 6).

A progressive tax rate is already in use under the province's land transfer tax (as well as in the City of Toronto). Here is how the province's land transfer tax works:

<u>Value Increments</u>	<u>Tax Rate</u>
Value up to and including \$55,000	0.5%
Value exceeding \$55,000 up to and including \$250,000	1.0%
Value exceeding \$250,000 up to and including \$400,000	1.5%
Value exceeding \$400,000	2.0%

The personal income tax also provides a precedent for the use of a progressive rate structure. Only incremental income is taxed at the higher marginal tax brackets, not all income.

Figure 6

### Comparison of Provincial Sales Tax on New Ownership Housing Under Progressive Tax Option

Price of New House	Proposed HST		Progressive Tax Option*	
	Effective Tax Rate	Dollars	Effective Tax Rate	Dollars
\$ 400,000	2%	\$ 8,000	2.0%	\$ 8,000
\$ 450,000	5%	\$ 22,500	2.7%	\$ 12,000
\$ 500,000	8%	\$ 40,000	3.2%	\$ 16,000
\$ 600,000	8%	\$ 48,000	4.0%	\$ 24,000
\$ 700,000	8%	\$ 56,000	4.6%	\$ 32,000
\$ 800,000	8%	\$ 64,000	5.0%	\$ 40,000
\$ 900,000	8%	\$ 72,000	5.3%	\$ 48,000
\$ 1,000,000	8%	\$ 80,000	5.6%	\$ 56,000
Additional Provincial Revenue over Existing PST		\$ 798 Million	\$ 366 Million	

\* 2% on first \$400,000, 8% on value over \$400,000  
Source: Altus Group Economic Consulting

This option would generate additional net provincial tax revenue of an estimated \$366 million.

It also serves to mitigate the 32% marginal tax anomaly created between the \$400,000 and \$500,000 threshold under the HST structure which has a disproportionate negative impact on GTA home buyers.

### 3.3 The Updated GST Price Thresholds Option

The third option, although a federal initiative, would improve the thresholds for the overall treatment of new housing under the proposed HST to reflect the current new housing market reality.

Raising the GST thresholds according to the New Housing Price Index published by Statistics Canada (a 56.75% increase since 1991 for Canada) would result in the following thresholds for ownership homes:

- New homes under \$550,000 would qualify for the full provincial and federal rebates; and
- New homes over \$700,000 would not qualify for a rebate (see Figure 7).

The proposed Ontario HST includes rebates based on the thresholds of homes valued at \$400,000 and \$500,000. These thresholds differ from the existing federal GST thresholds of \$350,000 and \$450,000. The federal

government has not changed the thresholds for the GST since its introduction in 1991.

The federal government should immediately update the 1991 GST rebate price thresholds from \$350,000 and \$450,000 for home inflation since 1991 to \$550,000 and \$700,000, with the Ontario government harmonizing to these new federal thresholds, along with regularly updating the thresholds for inflation in the future.

Under this option, the taxes levied on new housing would not record the full 8% rate until after \$700,000. Thus, there would be a marked drop in the effective tax rate on homes priced from \$400,000 to \$700,000 from what the province is proposing.

The province would also collect more HST revenue (about \$465 million) under this option than under the current PST.

Figure 7

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#### Comparison of Provincial Sales Tax on New Ownership Housing Under Updated GST Thresholds Option

Price of New House	Proposed HST		Updated GST Thresholds Option*	
	Effective Tax Rate	Dollars	Effective Tax Rate	Dollars
\$ 400,000	2%	\$ 8,000	2.0%	8,000
\$ 450,000	5%	\$ 22,500	2.0%	9,000
\$ 500,000	8%	\$ 40,000	2.0%	10,000
\$ 540,000	8%	\$ 43,200	2.0%	10,800
\$ 620,000	8%	\$ 49,600	5.0%	31,000
\$ 700,000	8%	\$ 56,000	8.0%	56,000
\$ 800,000	8%	\$ 64,000	8.0%	64,000
\$ 900,000	8%	\$ 72,000	8.0%	72,000
\$ 1,000,000	8%	\$ 80,000	8.0%	80,000
Additional Provincial Revenue over Existing PST		\$ 798 Million	\$ 464 Million	

\* Ontario Budget Proposal with updated federal GST thresholds of \$540,000 and \$700,000 (adjusting the 1991 thresholds (\$350,000 and \$450,000) by the increase in Statistics Canada's new housing price index for Canada between 1991 and 2008)  
Source: Altus Group Economic Consulting based on Statistics Canada data

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The Updated GST Price Threshold Option would be less effective than the Progressive Tax Rate Option in mitigating the negative economic impact of the current HST proposals but would ameliorate the disproportionate impact the current HST proposal would have on middle income households.

## 4. TRANSITION PROVISIONS

The introduction of any new tax or major alteration of the function of a present tax is sure to disrupt the normal operation of the housing market. The HST is scheduled to take effect on July 1, 2010 and is likely to have a profound negative impact on new homes in the pipeline without proper transition rules that recognize the lengthy investment, planning, development, sales and marketing and the building cycle inherent in residential construction, whether high-rise or low-rise.

The transition provisions need to be looked at from a buyer's standpoint in terms of the individual agreements of purchase and sale, along with protecting the project viability by understanding the economics of the entire project which go all the way back to the investment in the land and may take years to realize.

I take it as a given that there will be no retroactive taxation as a result of the HST and put forward the following scenarios relating to purchasers as well as projects, to ensure that outcome:

- New homes purchased prior to the budget (before March 26, 2009) that close after the implementation date (July 1, 2010) of the HST;
- New homes purchased after the budget (March 26, 2009) but before the scheduled implementation date of the HST (July 1, 2010) that close after the implementation date; and
- Projects registered with Tarion prior to the implementation date of the tax (July 1, 2010) with units closing after the implementation date of the tax.

### 4.1 New Homes Purchased Prior to the Budget

Obviously, anyone who entered into an agreement of purchase and sale prior to the budget should be exempt from the tax increase, regardless of when the unit closes. There are literally thousands of condominium purchasers in the GTA awaiting delivery of units in the post July 1, 2010 timeframe. Many of these agreements of purchase and sale include cost pass-through clauses so these buyers are anxiously awaiting clarification from the provincial government that there will be no retroactive taxation as a result of the HST.

#### **4.2 New Homes Purchased Since the Budget**

As noted above, the market for new homes over \$400,000 has been virtually paralyzed since the budget and the only way it can be revived is to clearly exempt agreements of purchase and sale entered into since the budget but prior to the implementation date of the tax, even if the home or condominium unit will be delivered after the implementation date of the tax.

#### **4.3 Projects Registered Prior to the Implementation Date of the Tax**

On the implementation date of the tax, there will obviously be Tarion-registered high-rise and low-rise projects on the market which were fully conceived, marketed and financed under the PST rules and which need to be completed under that tax regime within reason and recognizing the much slower absorption rates forecast for the mid-term compared to recent years.

**APPENDIX A**  
**CONCLUSIONS FROM PAPER ENTITLED**  
*New Housing is Different: Implications for*  
*Sales Tax Harmonization on New Home Buyers*  
*in Ontario*

## **Conclusions from Paper Entitled: *New Housing is Different: Implications for Sales Tax Harmonization on New Home Buyers in Ontario*<sup>8</sup>**

- It would be irresponsible to subject the full price of new homes to the HST:
  - New housing is unique from personal expenditure on goods and services in that it is an investment good providing a stream of consumption for 50 to 75 years or more into the future;
  - It also provides a stream of annual property tax payments over the life of the structure; and
  - New housing is already the target of a number of onerous government-imposed charges and other taxes including development charges, land transfer taxes and land dedications.
- Taxing new housing in the Greater Toronto Area (GTA) at the full rate of the new HST would have severe consequences on new home buyers, as well as the new housing industry and the economic sectors dependent on it:
  - Housing affordability would deteriorate and the volume of new residential construction would decline; and
  - The housing industry is an important engine of job growth directly or indirectly providing an estimated 325,000 jobs in Ontario in 2007. Any reduction in new housing construction activity because of HST implementation will cause job losses.
- In order to avoid a negative impact on housing affordability, the preferred HST treatment for new homes would be to apply a tax rate of approximately 2% to the price of new homes:
  - This is the estimated tax rate on new homes under the present PST resulting from the taxation of building materials.

<sup>8</sup> Frank A. Clayton, *New Housing is Different: Implications for Sales Tax Harmonization on New Home Buyers in Ontario*, March 2009, prepared for BILD before March 26<sup>th</sup> budget.

- Alternatively, if the relief were to be provided in the nature of a GST-style new housing tax rebate, the price thresholds for qualification should be realistic in terms of today's prices and updated for inflation in the future on a regular basis, unlike the GST price thresholds, which have not changed since 1991 when the tax was introduced, despite promises from the federal government at the time.



**APPENDIX B**

**Excerpt from**

*Altus Group Housing Report, March 2009*



# Altus Group

## HOUSING REPORT

### A NEW CMHC-COMMISSIONED STUDY TELLS US ABOUT GOVERNMENT-IMPOSED COSTS

Governments have a tendency to burden the new housing sector with additional costs in a bid to raise revenues (e.g., development charges, land transfer taxes), to enhance the “public good” (e.g., mandated “green” standards, contributions for public art or affordable housing), or as an inadvertent consequence of some other policies (e.g., sales tax harmonization). By increasing the costs of building new housing, these government-imposed costs are often counter to the economic well being of consumers. They can also be harmful to the economy at large and the new housing industry since most of the charges do not apply to the price of existing homes, which now become more financially attractive to prospective buyers.

This article examines how government-imposed costs vary across the country by level of government for a cross-section of municipalities, based on a new CMHC-commissioned study.<sup>1</sup> This information is helpful by placing proposed new or enlarged cost obligations by government within the context of the charges already being imposed by all three levels of government.

We then utilize this information to provide a context for assessing the implications of the sales tax harmonization being proposed by the Province of Ontario for new housing, which is the topic of this month’s insert.

#### The Study’s Approach

The study’s methodology consists of the following steps:

- Deriving standardized new dwellings (single-detached, townhouse, and condominium apartment) and median prices for up to 32 municipalities;
- Selecting and estimating government-imposed costs at all three levels of government; and
- Calculating government-imposed costs as a percent of the median sales prices of standardized new homes by type.

Government-imposed costs include municipal levies, fees and charges, provincial charges and taxes and the federal GST (Goods and Services Tax). The estimates do not include increases in development costs that result from having to meet building and land development requirements such as building codes, zoning requirements and other regulations like “green” building and subdivision regulations.

All estimates are for the year 2006. Since 2006, there are instances of significant increases in costs (e.g., the City of Toronto’s land transfer tax and development charges in Mississauga and

<sup>1</sup>Ray Tomalty and Andrejs Skaburskis, *Government-Imposed Charges on New Housing in Canada*, a Research Report prepared for CMHC, January 2009.

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#### HIGHLIGHTS

- The financial obligations imposed on new housing in relation to home prices by governments are highest in Ontario and B.C.
- The high municipal and federal costs in B.C. and Ontario more than offset the higher provincial costs in Quebec and Atlantic Canada resulting from the HST
- If the proposed HST in Ontario proceeds, Ontario will by far have the greatest financial burden on new homes priced \$400,000+
- Ontario's proposed increase in the tax burden from 2% for homes priced at \$400,000 or less to 8% for homes \$500,000+ will be extremely negative for the new home market



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Vaughan) and there are proposals for sizeable increases in municipalities like the City of Calgary. On the other hand, the Federal GST tax rate was 6% in 2006 but subsequently was reduced to 5%.

A premise of the estimates is the reasonable supposition that the government-imposed costs are reflected in the sales prices of new homes.

We have selected a cross section of municipalities in major urban areas for analysis in this article. For the three largest centres, data are provided for both the central city and a large suburb. The focus is on single-detached houses.

## Wide Variation in Burden of Government-Imposed Costs

There is wide variation in government-imposed costs as a percentage of median new single-detached houses in 2006 across Canada, both by municipality and by level of government (see Chart 1).

## The Aggregate Burden of Government-Imposed Costs is Highest in Suburban Toronto and Suburban Vancouver and Lowest in the Prairies

The relatively high government-imposed costs in suburban Toronto (17.1 to 17.9% of median price or \$72,794 to \$83,362) and suburban Vancouver (17.4% or \$86,896) are driven by sizeable municipal costs and the federal GST. These costs are relatively lower in the Prairies,

Chart 1

### Government-Imposed Costs by Level of Government as a Percent of Median-Priced New Single-Detached House, 2006

Municipalities	Median Price	Municipal	Provincial	Federal	Total
% of Median House Price					
Halifax	\$ 240,000	2.8	9.7	3.8	16.3
Montreal (City)	\$ 355,000	2.5	9.2	3.8	15.6
Laval	\$ 270,000	2.4	9.2	3.8	15.4
Gatineau	\$ 185,000	2.3	6.5	3.8	12.6
Ottawa	\$ 350,000	7.6	4.1	3.8	15.5
Toronto (City)	\$ 755,000	4.2	3.3	6.0	13.4
Mississauga	\$ 425,000	8.1	3.7	5.3	17.1
Vaughan	\$ 465,000	8.6	3.4	6.0	17.9
Winnipeg	\$ 240,000	2.9	4.0	3.8	10.7
Regina	\$ 235,000	4.6	2.3	3.8	10.8
Calgary	\$ 300,000	3.9	0.2	3.8	7.9
Edmonton	\$ 270,000	7.3	0.2	3.8	11.3
Vancouver (City)	\$ 715,000	2.3	3.1	6.0	11.4
Surrey	\$ 500,000	7.7	3.6	6.0	17.4

Note: Median price is sales price less GST.

Source: Altus Group Economic Consulting based on Ray Tomalty and Andrejs Skaburskis, *Government-Imposed Charges on New Housing in Canada, Final Report, January 2009*

ranging from 7.9% in Calgary to 11.3% in Edmonton (which are both in Alberta which has no Provincial Sales Tax).

## The Burden of Municipal Costs is Elevated in Ontario and B.C. with the Exception of the Two Large Central Cities

These large municipal costs are largely the product of provincially sanctioned Development Charges in Ontario and Development Cost Charges in B.C. These are intended to help pay for off-site infrastructure required by new housing development.

Here is what the study says about the rationale for these charges: "In theory, there is supposed to be a connection between the nature of the development being levied and the off-site services obtained, but this is often difficult to assess in practice" (p. 14).

## Relative Municipal Costs are Lower in Two of the Three Largest Urban Centres Examined Than in the Suburbs

The estimated relative municipal cost burdens in the City of Vancouver and the City of Toronto are significantly less than in the suburbs examined (by 50% or more). In the Montreal area in contrast, the City of Montreal and Laval impose about the same burden.

There is a rationale for the quantum of costs levied on new residential development being considerably lower in the central city of a large urban centre than the suburbs. Much of the required infrastructure is already built in the central city, so that growth can be accommodated relatively inexpensively. Moreover, the existing infrastructure at one time accommodated a population much larger than the current popu-

lation. This contrasts with greenfield development in the suburbs that requires extension of trunk services, roads, transit and other growth-related infrastructure.

In 2006, Toronto and Vancouver fit this model but Montreal does not. There are signs this may be changing in these two areas. The City of Vancouver has nearly doubled its Development Cost Levies on new ground-related housing since 2006, the base year for the CMHC study. Under a by-law passed in February, the City of Toronto intends to increase its development charges on new single-detached and semi-detached homes over time from \$11,082 to \$21,044.

## The Burden of Provincial Costs Highest in Atlantic Canada and Quebec

Provincial costs as percent of median price range from 9.2% to 9.7% in Halifax and in the Montreal area, in conspicuous contrast with Calgary and Edmonton's 0.2%. Both the Atlantic Provinces and Quebec tax the full sales price of new housing under their Harmonized Sales Taxes (HST). The Gatineau burden is much less because with the low median house price there, the standard house qualifies for a rebate, whereas the Montreal area houses do not.

## The Federal Government Burden is Most Pronounced in Ontario and B.C.

These two provinces have the highest level of prices for new homes

and with the median prices in the CMHC commissioned study do not qualify for the federal GST rebate or for a partial rebate (Mississauga). In other parts of the country, median prices are low enough for the new house to qualify for the full GST rebate.

The federal government had promised to update the price thresholds for the GST rebate (full and partial) when it introduced the GST in 1991. If the federal government had followed through on its promise, and price movement from Statistics Canada's New Housing Price Index are applied, the current price thresholds would be:

- New homes eligible for full GST new home rebate: \$549,000 instead of the existing \$350,000; and
- New homes eligible for a partial rebate: between \$549,999 and \$705,000, instead of the existing \$350,000 to \$450,000.

What this means is that more and more new houses are subject to the full GST as new home prices rise with inflation, contrary to the federal promise. This amounts to thousands of dollars of taxes per home simply due to the static price thresholds.

## Implications for Ontario Sales Tax Harmonization

Our analysis of the CMHC study provides some meaningful parameters for the Ontario Government to consider in the design of its Harmonized Sales Tax (HST) proposal as it relates to new ownership housing including:

- Any tax proposal on new housing must take into consideration the relatively high level of government-imposed costs now being imposed on new housing in the province by municipalities, the province and the federal government to minimize adverse economic consequences; and
- The relatively high level of new housing prices in Ontario, especially in the Toronto urban region, compared to many other parts of the country must also be taken into consideration in order to minimize adverse economic consequences.

Chart 1 documents that government-imposed costs in the Ontario municipalities examined already are amongst the highest in Canada without any increase in burden from an HST. This occurs for two reasons: (1) the very high municipal costs in Ontario and (2) the higher effective GST tax rate applied to many Ontario new homes. This contrasts with the situation in the Atlantic Provinces or Quebec where municipal costs and housing prices are relatively low, both now and in the mid 1990s when the HST was introduced.

Additional government-imposed charges under a HST will push Ontario into a category all by itself in terms of the quantum of the costs governments impose on new housing within its borders. The higher the taxes the larger the negative implications of the HST on the volume of new housing construction and the Ontario economy in terms of economic activity, jobs, and taxation revenues.