The Origin of Transition Ratios

A key element of the property tax system introduced in 1998 was tax ratios. Tax ratios represent the relationship between tax rates for all non-residential property classes and the rate for the residential class. The *Act* contains a number of tax ratio-related terms but perhaps the least understood are the "transition ratios", which refer to the ratios that were prescribed at the time of the changeover to the new system.

How were these mysterious ratios established? The answer, with very few exceptions, is that they were the ratios between effective tax rates that applied to the other classes of properties in the year immediately prior to the introduction of the reforms. As such they perpetuated the inequities that existed under the pre-reform system, albeit in a much more transparent form.

In the pre-reform era there were only two tax rates—residential and commercial—and the residential rate was set at 85% of the commercial rate. In addition, properties occupied by businesses paid what amounted to a surcharge in the form of a business tax. The surcharge rate varied according to the type of business. As a result, commercially classified properties paid proportionally more taxes than properties subject to the residential rate. For example, a commercially taxed property occupied by a business to which a 30% business tax rate applied would have been subject to an effective tax ratio of 1.53 compared to 1.00 for a residentially taxed property.

Commercial Tax Rate (1.00) +
Business Tax Rate (0.30) =
Overall Tax Rate (1.30)

Residential Tax Rate	0.85
Effective Tax Ratio	1.30/0.85 = 1.53

The second major reason for the difference between the effective rate applied to residential properties compared to other classes of property was the assessments. Unlike under today's system where all properties are assessed on a common current market value basis (CVA) prior to the reforms there was very little consistency between assessments and market value. As a general rule residential properties were assessed for much less relative to their market value than was the case for other classes of properties.

This was especially true for commercial and industrial properties. When this factor was combined with the mill rate and business tax difference described above the result was an even larger differential (ratio) between the effective tax rates applied to residential properties compared to the rates for other classes of property. It is these ratio differences between the taxation of residential properties and other types of property immediately prior to the introduction of the CVA-based tax system in 1998 that were the basis of the transition ratios that were calculated by the Ontario Ministry of Finance.

The transition ratios were the essential link which enabled municipalities to move to the new world of CVAs and tax rates while at the same time roughly maintaining the tax burdens of each property class at pre-reform levels. Importantly, however, while the transition ratios facilitated a broad status quo situation at the class level it did not prevent property-by-property tax shifts arising from the reforms. These shifts proved to be very substantial and led to the introduction of the mandatory capping program.