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Taxation Panel

Municipal Power to Tax: Jurisdiction and Practicalities

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Introduction and Overview

Emboldened by a decade's long series of supportive Court decisions and numerous new "Municipal Acts", municipalities in Canada progressively sought additional sources of revenue to provide a predictable and controllable source of funding for the new regulatory and service provision authorities granted to them. While the permissive new Municipal Acts and the empowering Court decisions have given municipal governments new and much greater discretion for the way in which they exercise their powers, the old saying: "he who pays the piper calls the tune" continues as revenue sources are still dependent on grants and transfers from the provincial governments who may then dictate in a practical sense, municipal policy decisions by holding the purse strings.

Significantly, in Canada, there are only two municipal entities, the City of Montreal and the City of Toronto, who have a true taxation power which is presented as tax for the purpose of raising revenue. Otherwise, municipalities are still relegated to the very restrictive and cumbersome real property tax and the various forms of user fees all of which are supplemented by provincial government transfers whose revenues are raised from a variety of sources.

This paper will look at the taxing regimes in the City of Montreal as well at the City of Toronto and, for comparison purposes, consider those of the City of Austin, Texas. Given the author's location and experience with municipal taxes, there will be a great emphasis on those allowed to the City of Toronto. As well, we shall discuss a matter currently before the Supreme Court of Canada that the author had been involved regarding a challenge to the City of Toronto's sign tax by-law and the implications for the use of the City of Toronto's as well as debatably the City of Montreal's, new taxing power.

Municipalities and Taxation

Traditionally, municipalities have depended for their revenues on real property taxes. These provided a very restrictive pool of revenue and a cumbersome system for assessment of the tax and its collection. These revenues were supplemented by license fees and more recently user fees which were intended to offset a municipality's cost of providing a service. As well, a substantive source of funding was payments from the provincial government to local municipalities either as unconditional grants or for specific projects, such as transit, sewer infrastructures, policing, etc. As we shall see later in the paper, the system in Canada is very different than that in the United States of America using Austin, Texas as a typical example.

In Ontario, the revenue raising tools were dramatically modified in 1996 by the *Savings and Restructuring Act, 1996*, S.O. 1996, c. 1 which introduced substantive amendments to the *Municipal Act*. Amongst these amendments was the introduction in Part XII known as Fees and Charges. The money raising authority was introduced to help offset the increased responsibilities and services

required to be provided by municipalities occasioned by provincial downloading in the late 1990's. As we note in the Ontario Municipal Act & Commentary[1]:

> "Section 220.1 enabled municipalities and their local boards (and any other bodies prescribed by regulation) to pass by-laws imposing fees or charges on any class of persons. The new power allowed municipalities to charge so-called "user fees". "Person" was broadly defined and included a corporation or an area municipality.
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> The fee or charge could be for:
>
> (i) services or activities provided by the municipality;
>
> (ii) costs payable by a municipality for services provided by another municipality or local board; or
>
> (iii) the use of the municipal real or personal property and for property under its control.
>
> Section 220.1 provided a broad power to pass by-laws for the purpose of collecting fees and charges. The provisions were some of the most debated and controversial amendments contained in the *Savings and Restructuring Act, 1996*. Section 220.1 essentially provided that where there was a direct relationship with the ultimate user of a service or activity, a municipality or its local boards could charge any fee or charge they considered reasonable. The legislation was explicit in providing that a by-law could impose a user fee or charge "in the nature of a direct tax for the purpose of raising revenue". (Similar language contained in the first reading version of Bill 26 with reference to licence fees in subclause 257.2(2)(f)(i) was subsequently deleted.) However, the Minister of Municipal Affairs and Housing retained a general residual power to exempt any class or person from user fees. This was a very significant limitation on the power sought to be given to municipalities, which the Minister did not hesitate to use: O. Reg. 26/96 – *Fees and Charges* exempted, *inter alia,* the Crown, telecommunications providers, waste collection and recycling services, and municipal and local board elections."

A number of Court cases looked at and to some extent read down the taxation for the purpose of raising revenues aspect by requiring some nexus between the amount charged and the cost of service for which was levied. For example, in a matter which I was involved in, *Urban Outdoor Trans Ad v. Scarborough (City)* involved a sign fee (tax) by-law which attempted to collect monies by way of an auction for the right to apply for a sign permit of which a restrictive number of new permits were to be issued in the former City of Scarborough (Toronto). As

[1] John Mascarin and Christopher J. Williams, *Ontario Municipal Act & Commentary, 2012 Edition*, LexisNexis, Markham, 2011, pp. 73-74.

well, the by-law had an annual fee which every owner of the sign had to pay in the amount of $100 or $200 per sign. The Superior Court of Justice agreed with the sign company's position that the auction for the right to apply for signs was not a user fee but a tax and in fact was an indirect tax as its natural tendency would be to pass it along to users of the advertising space for its advertisers. However, the Superior Court and later the Court of Appeal found that the annual fee was a user fee as the City had been able to demonstrate some connection or nexus between quantum (said by the Court to be very modest) collected and the services provided by the sign section of the building department. The Court of Appeal also implied that if the annual fee was a tax, it would be in the nature of a direct tax and therefore permissible. The Court of Appeal did not deal with the sign auction fee/tax as the same had not been appealed to the City.

The *Municipal Act, 2001* removed the words "will be in the nature of a direct tax for the purpose of raising revenue" from the current user fee provisions. Otherwise, the old provisions of the *Municipal Act* section 220.1 were largely carried forward into the new Part XII of the *Municipal Act, 2001*. As well, section 17 of the *Municipal Act, 2001* provides that the general grants and powers of the *Municipal Act, 2001* do not permit the municipality to impose taxes. The user fee powers in Part XII of the *Municipal Act, 2001* were modified a little through the Bill 130 amendments as the process for creating fees was made easier.

Therefore, municipalities had debatably been given in Ontario some form of taxing power in the *Savings and Restructuring Act, 1996.* That authority had been restricted but not eliminated by the Courts but then the provincial government when they enacted the *Municipal Act, 2001* took that power away and specifically prohibited municipalities from using its powers to impose a tax.

The City of Toronto's Taxation Powers

With the formulation and introduction of the *City of Toronto Act, 2006,* S.O. 2006, c. 11, Sched. A the Province added (or reinstated) the taxing powers for the purpose of raising revenue only to the City of Toronto. This is found in Part X of the *City of Toronto Act, 2006* and it is exclusive to the City.

The City of Toronto, therefore, in addition to real property taxes and some user fees provisions found in the *Municipal Act, 2001*, now has the ability to raise revenues through a true tax. The taxes are expressed as being direct and subject to the restrictions set out in Part X and regulations made thereunder. The basic criteria and content is quite simple in that a by-law must: (a) state the subject of the tax to be proposed; (b) provide for the tax amount; and (c) provide the manner in which the tax is to be collected. The by-law may also, at the discretion of the City council, provide for exemptions, rebates, penalties, interest, dispute resolution mechanisms, enforcement measures and whatever other matters council deems appropriate. However, subsection 267(2) of the *City of Toronto Act, 2006* specifically prohibits a number of taxes which would otherwise be available for the City to utilize and which, as we shall see, are utilized in American jurisdictions. These restrictions specifically prohibit the following:

> "(a) income tax and sales tax;

(b) capital tax;

(c) tax on lodging, such as hotel, motel, apartment house, boarding house and club;

(d) tax on the supply of natural gas or artificial gas;

(e) tax on consumption or use of energy, including electricity;

(f) tax on the generation, exploitation, extraction, harvesting, processing, renewal or transportation of natural resources;

(g) tax on the use of a highway in respect of equipment placed under, on or over the highway for the purpose of supplying a service to the public;

(h) tax on wealth, including inheritance;

(i) a poll tax; and

(j) tax on machinery and equipment used in research and development or used in manufacturing and processing and on assets used to enhance productivity, including computer hardware and software."

The Province, through legislation, also exempted a number of entities from tax. These include:

1. the Province, its agencies, boards and commissions;

2. school boards;

3. universities and colleges;

4. private and public hospitals and community psychiatric hospitals;

5. nursing homes and homes for the aged;

6. long-term care homes; and

7. prescribed persons or entities. So far, no persons or entities have been prescribed.

As well, section 272 provides a regulatory power whereby the Cabinet, on the recommendation of the Minister of Finance, can prescribe additional conditions that are a prerequisite to a tax by-law, prescribe the persons or entities not subject to the tax, define words or phrases, and essentially do anything else in the interest of the Province it wishes as regards to City of Toronto taxes.

It is interesting to see the striking similarity between the City of Toronto taxation powers and the original user fee powers granted to all municipalities in 1996. As

well, section 25 of the *City of Toronto Act, 1996* provides that the provincial Cabinet can, if it considers it desirable, enact a regulation imposing its conditions on amongst other powers, the taxing powers. The City of Toronto, following a number of studies, proceeded to enact a taxing by-law of the ownership on the transfer of real property, motor vehicles, and signs. The motor vehicle ownership was recently terminated and the sign tax by-law is currently before the Supreme Court of Canada.

Similarly, the *Charter of Ville de Montréal* while allowing in general terms taxing by-laws, specifically prohibits a vast number of taxes:

> 151.8. The city may, by by-law, impose a municipal tax in its territory if it is a direct tax and if the by-law satisfies the criteria set out in the fourth paragraph.
>
> The city is not authorized to impose the following taxes:
>
> (1) a tax in respect of the supply of a property or a service;
>
> (2) a tax on income, revenue, profits or receipts, or in respect of similar amounts;
>
> (3) a tax on paid-up capital, reserves, retained earnings, contributed surplus or indebtedness, or in respect of similar amounts;
>
> (4) a tax in respect of machinery and equipment used in scientific research and experimental development or in manufacturing and processing or in respect of any assets used to enhance productivity, including computer hardware and software;
>
> (5) a tax in respect of remuneration that an employer pays or must pay for services, including non-monetary remuneration that the employer confers or must confer;
>
> (6) a tax on wealth, including an inheritance tax;
>
> (7) a tax on an individual because the individual is present or resides in the territory of the city;
>
> (8) a tax in respect of alcoholic beverages within the meaning of section 2 of the Act respecting offences relating to alcoholic beverages (chapter I-8.1);
>
> (9) a tax in respect of tobacco or raw tobacco within the meaning of section 2 of the Tobacco Tax Act (chapter I-2);
>
> (10) a tax in respect of fuel within the meaning of section 1 of the Fuel Tax Act (chapter T-1);
>
> (11) a tax in respect of a natural resource;

(12) a tax in respect of energy, in particular electric power; or

(13) a tax collected from a person who uses a public highway within the meaning of section 4 of the Highway Safety Code (chapter C-24.2), in respect of equipment placed under, on or above a public highway to provide a public service.

Similar to the province of Ontario, Quebec has exempted a number of entities from tax. These include:

(1) the State, the Crown in right of Canada or one of their mandataries;

(2) a school board, a general and vocational college, a university establishment within the meaning of the University Investments Act (chapter I-17) or the Conservatoire de musique et d'art dramatique du Québec;

(3) a private educational institution operated by a non-profit body in respect of an activity that is exercised in accordance with a permit issued under the Act respecting private education (chapter E-9.1), a private educational institution accredited for purposes of subsidies under that Act or an institution whose instructional program is the subject of an international agreement within the meaning of the Act respecting the Ministère des Relations internationales (chapter M-25.1.1);

(4) a public institution within the meaning of the Act respecting health services and social services (chapter S-4.2) or a health and social services agency governed by that Act;

(5) a private institution referred to in paragraph 3 of section 99 or section 551 of the Act respecting health services and social services in respect of an activity that is exercised in accordance with a permit issued to the institution under that Act and is inherent in the mission of a local community service centre, a residential and long-term care centre or a rehabilitation centre within the meaning of that Act; or

(6) any other person determined by a regulation of the Government.

The challenge to the sign tax by-law by OMAC and Pattison Outdoor, et al represents the only challenge to the new taxation powers in the City of Toronto or the City of Montreal which we could find. Before we delve into the Superior Court and Court of Appeal decisions and the issues before the Supreme Court of Canada, let's look at how things are done elsewhere.

Canada-USA Comparison

It is instructive to compare the Canadian municipal taxation regime to that of the United States of America to examine how Canadian grants of power may evolve over time. As will be seen, the American system has traditionally been easily distinguishable from the Canadian approach and if the trend of large Canadian municipalities gaining a real revenue raising power continues, then the increase

taxation powers granted to the City of Toronto and the City of Montreal will move more toward the American experience. This section will examine the differences between the two taxation regimes using the City of Austin, Texas as an example, and it will serve to provide context to the matter currently before the Supreme Court of Canada.

Local Taxation Authority under the Texas Tax Code

The state of Texas has defined its taxation powers and those granted to municipalities and counties through the Texas Tax Code. The Texas Tax Code is divided into three Titles,

Title 1. Property Tax Code
Title 2. State Taxation
Title 3. Local Taxation

Of particular interest to the focus of this paper is Title 3, Local Taxation.

The Texas Tax Code, Title 3, Subtitle A - *General Taxing Authority and Provisions* provides a general grant of taxation powers to local Texas authorities. A Canadian municipality can be granted the ability to levy general taxes from the province through its enabling legislation, and thus far only the *City of Toronto Act, 2006* and the *Charter of Ville de Montréal,* R.S.Q., c. C-11.4 have been granted sufficient authority. This discrepancy has likely resulted from the different approaches to taxation policy implemented in each country. In Canada, the Constitutional division of powers has resulted in provincial jurisdiction and responsibility for funding local services including, but not limited to, school boards, health care and long-term care services, and post-secondary education. Given the different funding source between Canada and the United States of America, and the resulting divergence in policy options, there is an intrinsically different context that did not require the province to provide a general ability to impose a levy in the nature of taxation to municipalities. However, as provinces have increasingly delegated service provision to municipalities, the recent grants to two of Canada's largest cities to levy general taxes would appear to be designed to address these funding deficits. Given America's long experience with delegated funding and service provision, it is instructive to examine the current differences between the grants of powers provided by the provinces of Ontario and Quebec and the State of Texas that will be highlighted in this section.

Excise Taxes

The power to impose an excise tax is contained within Texas Tax Code, Title 3, Subtitle A, Chapter 302 – *Taxation powers of Municipalities*, Subchapter B. The grant of powers under Subchapter B provides:

> Sec. 302.101. OCCUPATION TAXES.
> (a) The governing body of a municipality, other than a Type C general-law municipality having 200 or fewer inhabitants, may impose and collect occupation taxes.
> (b) A license required by a Type A general-law municipality may not extend to more than one establishment or apply to more than

> one occupation, business, or calling and may not be imposed except by a vote of two-thirds of the elected aldermen.
> Added by Acts 1987, 70th Leg., ch. 191, Sec. 1, eff. Sept. 1, 1987.
>
> Sec. 302.102. TAX COLLECTION POWERS.
> (a) The governing body of a Type A general-law municipality may adopt ordinances and make rules relating to the imposition, assessment, and collection of taxes, except ad valorem taxes, authorized by this subchapter. An ordinance may provide for the sale of real and personal property for the collection of a tax authorized by this subchapter.
> (b) A home-rule municipality may collect taxes that are authorized by the charter of the municipality or by law and may impose penalties for delinquent taxes. This subsection does not apply to property taxes.
> Added by Acts 1987, 70th Leg., ch. 191, Sec. 1, eff. Sept. 1, 1987.

This grant of powers by the state of Texas is much broader in its application and the number of municipalities that are authorized to impose taxes than in Canada. The Provinces of Ontario and Quebec have not provided a broad grant of powers to all municipalities to impose general excise taxes, but have strictly limited its manner of application and its scope to the Cities of Toronto and Montreal.

However, both Canadian and American legislation provide for harmonized tax collection. The *Charter of Ville de Montréal* specifically authorizes in Division III - *General Taxation Power*, s. 151.12,

> The city may enter into an agreement with another person, including the State, providing for the collection and recovery of a tax imposed under section 151.8 [which permits the city to impose a municipal tax in its territory if it is a direct tax and if the by-law satisfies the criteria set out] and the administration and enforcement of a by-law imposing the tax. The agreement may authorize the person to collect the taxes and oversee the administration and enforcement of the by-law on the city's behalf.

The *City of Toronto Act, 2006* provides a virtually identical provision in s. 271,

> The City may enter into agreements with another person or entity, including the Crown, providing for the collection of taxes imposed under section 267 and the administration and enforcement of the by-law imposing the taxes and the agreement may authorize the person or entity to collect taxes and administer and enforce the by-law on the City's behalf.

Sales and Use Taxes

Subtitle C "Local Sales and Use Taxes" enables municipalities to impose specific sales and use taxes. Under Chapter 321 of the Texas Tax Code, Title 3, Subtitle C, Subchapter B – *Imposition of Sales and Use Taxes by Municipalities*, Sec. 321.101(a) provides,

> A municipality may adopt or repeal a sales and use tax authorized by this chapter, other than the additional municipal sales and use tax, at an election in which a majority of the qualified voters of the municipality approve the adoption or repeal of the tax.

The Texan approach differs significantly from the Canadian approach. Firstly, clause 267(2)(a) of the *City of Toronto Act, 2006* and paragraph 151.8(1) of the *Charter of Ville de Montréal* specifically prohibit the imposition a sales tax. Therefore, the provincial and federal government have retained exclusive powers to levy sales taxes and have not demonstrated any intention to grant such authority to a municipality. Secondly, it is through the enactment of a municipal by-law, rather than a vote in a general election, that provides the requisite authority to levy municipal taxes.

Similar exemptions from Local Taxation for Telephone Companies

It should be noted that an exemption is made from the excise tax for telephone companies under Chapter 301 of the Texas Tax Code, Title 3, Subtitle A, Sec. 301.004 – *Telephone Company Exemption*, which provides that "(a) municipality or other political subdivision of this state may not impose an occupation tax or any charge for the privilege of doing business on a telephone company taxed under Chapter 171 of this code..." However, this section does permit municipalities to collect taxes from a telephone company through a number of exceptions to the exemption. Telephone companies can be compelled to pay taxes through: a grandfathered franchise tax; ad valorem (property) taxes; and contracts made between a municipality and a franchise holder. Protection for telephone companies has also been granted in Ontario, as O. Reg. 26/96 – *Fees and Charges* specifically exempted, among other entities, telecommunications providers from user fees.

Additional Differences in Local Taxation between Canada and the USA

Additional Acts under the Texas Tax Code that permit taxes to be levied include: Special Purpose Taxing Authorities Sales and Use (Chapter 322); County Sales and Use (Chapter 323); County Health Services Sales and Use (Chapter 324); Landfill and Criminal Detention Center County Sales and Use (Chapter 325); Street Maintenance Municipal Sales And Use (Chapter 327); Municipal Hotel Occupancy (Chapter 351); and County Hotel Occupancy (Chapter 352). Each of these additional Acts grant the power to either the city, county or a special purpose entity to levy a local tax. The use of these special purpose taxing authorities and city taxation powers will now be examined in greater depth using the City of Austin, Texas as a specific example.

Special Purpose Taxing Authorities

As discussed previously, in Canada, only the City of Toronto and the City of Montreal, the provinces and the federal government have the right to levy general taxes. The municipalities are specifically prohibited from levying a sales tax. Through their respective legislation, regulations and by-laws, Canadian provinces and cities attempt to provide sufficient funding for the development and maintenance of essential local services. Within the American context, special

purpose taxing authorities are created to provide the same services, but in a manner that more directly raises funds to achieve the specific goal.

Special purpose taxing authorities are a significant difference between the American and Canadian approach to municipal taxation. These distinct entities that are empowered to levy local property and sales tax. As indicated by its name, a special purpose taxing authority may levy taxes to accomplish a particular goal and is explicitly permitted by Chapter 322 of the Texas Tax Code to benefit from the imposition of a Sales and Use Tax. Local entities that may levy property and sales and use taxes include cities, counties and special purpose districts. In addition to districts that collect property tax or sales tax, there are other special purpose districts that can collect user fees. Special purpose districts include, but are not limited to, crime control, emergency service, hospital, library and utility districts. There are more than 40 distinct forms of special purpose taxing authorities that have been created in the state of Texas. In Travis County (where the City of Austin is located), in addition to taxes levied by the City and County, there are taxes levied by: thirty-nine municipal utility districts; twenty water control and improvement districts; fifteen school districts; fourteen emergency services districts; two road districts; a drainage district; a junior college or college district; a limited district, a hospital district, and a utility district. [2]

Taxation Power of the City of Austin, Texas

In Texas, local tax authorities may impose a sales and use tax up to a maximum levy of two percent. Currently, Texas' sales and use tax rate is 6.25 percent, resulting in a maximum combined rate of 8.25 percent. The City of Austin has levied a general sales and uses tax for just over 45 years This sales and uses tax was approved by local citizens in a September 30, 1967 election, as required under Texas Tax Code Chapter 321. As mentioned previously, the province of Ontario has not provided a similar taxing power to the City of Toronto, which demonstrates a significant difference in the historical and current approaches to funding local essential services and developments.

Under Sec. 302.102(b) of the Texas Tax Code, the City of Austin also has the power to "collect taxes that are authorized by the charter of the municipality or by law and may impose penalties for delinquent taxes". Under Title 11 of the Code of the City of Austin, the municipality has levied taxes in the nature of:

11-1. AD VALOREM TAX [PROPERTY]
11-2. HOTEL OCCUPANCY TAX
11-3. MOTOR VEHICLE RENTAL TAX
11-4. OCCUPATION TAX
11-5. TELECOMMUNICATION SERVICES TAX

[2] A useful summary of the implementation of Texan tax policy and special taxing purpose entities is provided at (http://www.texastransparency.org/yourmoney/localtax/entities.php), which summarizes information from the Texas Comptroller of Public Accounts:

This authority once again demonstrates a different approach from that of the Canadian provinces, which have explicitly excluded the use of a sales tax by either the City of Toronto and the City of Montreal, and Ontario has explicitly excluded a tax on lodging and telecommunications services.

Standing to challenge Municipal Taxes

In the United States of America, standing exists in actions brought by taxpayers to challenge municipal taxes. In *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332 (2006), Ohio taxpayers sought to challenge a state tax credit allowed against state taxes for the construction of a new manufacturing facility in the state as discriminatory and in violation of the Commerce Clause. The U.S. Supreme Court held that the taxpayer did not have standing because they suffered in some indefinite way, the injury was in common with people generally, and the injury was conjectural or hypothetical. The Court held that the decision as to how to allocate taxation was the epitome of a policy judgment committed to the discretion of lawmakers, which the court could not presume to either control or predict. However, these taxpayers also challenged a municipal property tax exemption. While the Court held that standing as a municipal taxpayer does not confer standing as state taxpayers, *Massachusetts v. Mellon*, 262 U.S. 447 (1923) demonstrates that an exception to the taxpayer standing rule exists for municipal taxes as distinct from state taxes. As stated in *Flast v. Cohen*, 392 U.S. 83 (1968), "(t)he interest of a taxpayer of a municipality in the application of its money is direct and immediate and the remedy by injunction to prevent their misuse is not inappropriate."

In Canada, standing has been granted to industry associations to challenge municipal taxes, as is demonstrated by *Urban Outdoor Trans Ad v. Scarborough (City)* and *Out-Of-Home Marketing Association of Canada, et al v. Toronto (City).* An appeal on the later matter is now before the Supreme Court of Canada and will be discussed in the following section.

The *OMAC, et al v. Toronto (City)* Challenge

The only legal challenge of the municipal taxation powers afforded to the City of Montreal and the City of Toronto was against the City of Toronto's sign tax by-law commenced by the Out-of-Home Marketing Association of Canada ("OMAC") and joined in by Pattison Outdoor Advertising and Pattison Sign Group (collectively "Pattison"). This matter is currently before the Supreme Court of Canada awaiting a decision on leave to appeal which is expected shortly.

History and Background

In early 2010, the City of Toronto enacted four by-laws contemporaneously regarding signs. They related to sign regulation, recovery of the City's costs for regulating signs, and revenue generation. The sign tax by-law applied only to third-party signs containing sign copy. The tax applies and is paid by the person who "owns and controls the sign copy". The sign tax by-law created five classes of sign structures based upon the type of sign and size, with a slight rate scale (as of 2011) from $1,150.00 all the way to $24,000.00 per year, per sign. According to the City's own documents, in addition to raising revenue the sign tax

by-law was intended to compliment the regulatory by-law presumably by discouraging through a higher rate certain types of signs.

The by-law was challenged by OMAC, an industry association comprised of members of the larger companies who sell out of home advertising space, largely billboards. The other applicant, Pattison, is a company that sells out of home advertising space on signs. The application was commenced pursuant to section 214 of the *City of Toronto Act, 2006* which provides the Superior Court of Justice with the authority to quash a by-law or part for illegality. It should also be noted that the *City of Toronto Act, 2006* as well as the *Municipal Act, 2001* prohibit a Court from quashing for unreasonableness only a municipal by-law. The application proceeded through to a hearing before Mr. Justice Penny of the Superior Court of Justice over several days in the fall of 2010. OMAC provided affidavit evidence through a principal of OMAC and Dr. Clayton, a well-known economist. Pattison provided evidence through a senior officer and through Dr. Stiroh, a well-regarded economist from the United States. The City provided evidence through two staff members who had been involved in the formulation of the by-law.

The by-law was challenged on several grounds:

(1) the by-law was an indirect tax and as such contravenes the *City of Toronto Act, 2006* and the *Constitution Act*;

(2) the by-law was a tax on revenues which was prohibited under the *City of Toronto Act, 2006* and as such, contravenes it;

(3) the by-law was enacted for an improper and collateral purpose, and unlawfully discriminates by attempting to design a tax those signs that are the subject of a written or sharing agreement with the City thereby making signs on the City owned property more valuable than those signs on non-City owned property.

As well, the applicants sought a declaration that by virtue of subsection 110.1 of the *City of Toronto Act, 2006* the signs are grandfathered with the effect that the sign tax would not apply to the signs erected prior to the effective date of the sign tax by-law.

It was the position of the applicants that the sign tax by-law levied a rate that, as provided for in their experts' reports, was equal to or exceeded the profit earned by the third-party sign owners. Therefore, of necessity, it would have to be passed along to advertisers through higher advertising rates or back to the landowners through reduced lease rates and as such, of necessity, constituted an indirect tax whose natural tendency would be to be passed on to someone else.

The quantum of the tax varied according to sign type and size. In various background reports, the City had referenced an effective rate being deemed 7%

of average earned revenues per sign. On that basis, it was argued that the sign tax was in fact a tax on revenue which, as noted above, is specifically prohibited.

The applicants also argued that the by-law was discriminatory on the basis that it exempted from the tax signs that had been erected on City property pursuant to agreements with a sign company. The particular agreement in question, gave the City a portion of the profits earned by the sign company and so the argument was that the City was improperly using a tax to better its business position as a joint venture with respect to some insights on property. By not levying a tax on its joint ventured signs, the signs on the City property would be less expensive and therefore more valuable and plentiful.

The final argument of the applicants revolved around section 110 of the *City of Toronto Act, 2006* which exempted the existing signs from the application of the new City by-law "respecting advertising devices, including signs, does not apply to an advertising device that was lawfully erected or displayed on the day the by-law comes into force…".

The City argued that based upon the existing precedent including the Court's earlier decision on user fees of *Urban Outdoor Trans Ad v. Scarborough (City)* and other authority that while the sign tax or a portion thereof may attempt to be passed along to others, that was not its natural tendency or its intent unlike other direct taxes, such as an excise or customs tax. The City argued that the tax was essentially a flat rate on different types of signs and made reference to a revenue equivalency was done simply as part of a modeling exercise to ensure that the rate was not too high as to be prohibitive. With respect to discrimination, the City pointed out that it has the statutory authority to discriminate and that it doesn't need to tax signs on its own property as it receives revenues through its agreed sign company using its space. With respect to grandfathering, it was the City's position that section 110 of the *City of Toronto Act, 2006* only applies to regulatory by-laws regarding signs and not other types of by-laws related to signs.

Justice Penny in a 50-page decision released in March, 2011 rejected the applicants' position that the sign tax by-law was unconstitutional as an indirect tax. Justice Penny analyzed various authorities in this regard as follows:

> "[110] While the observations of Rosenberg J.A. in the *Urban Outdoor Trans Ad* case, *supra* quoted above were explicitly *obiter*, they are, in my respectful view, nevertheless on the right track. The tax in issue here is similar to a land tax in that it is paid on permanent fixtures (i.e., property) within the City. The tax is not tied to the number of times the billboard space is used or sold to an advertiser, to the content of the advertising or to the revenue generated for the sign owner through the use of the sign to display the advertiser's message. Nor is the tax targeted at *the amount of time* the sign is actually displaying advertising copy. It is sufficient, to attract the tax, that the sign is *used* to display advertising.
>
> [111] Sign owners do not sell signs. They sell advertising space displayed on the signs. The signs, therefore, are not the

> commodity. The "good" or "commodity" being marketed is the advertising space. The tax is not targeted at the commodity. It is targeted at a fixture which, by the nature of its use, intrudes into the public spaces of the City. The billboards are used as part of both national and local advertising campaigns. The tax is not, however, targeted at these campaigns. The tax is not on the advertising displayed on the signs but on the physical structure itself. Accordingly, the tax does not apply or attach to the "good" or "commodity" being marketed by the sign owner. The tax, I find, does not "cling," to a unit of production in the course of being marketed. It does not move with the good through the supply chain.
>
> [112] As Professor Hogg said, it is neither possible nor desirable to exclude from the provincial taxing power any tax that is in fact recouped by the initial taxpayer. If the tax under the Bylaw is indirect because it may be recouped in part from landlords or advertisers, it is hard to see how almost any provincial tax on a business or commercial enterprise could survive constitutional scrutiny.
>
> [113] For these reasons, I do not think it can be said that the general tendency of the tax under the Bylaw, *for constitutional purposes*, is that it will be passed on. As a result, the true nature of the tax is not indirect.
>
> [114] In sum, on Issue #1, having regard to the principles set out in the authorities cited above and the factors identified as illuminating the question of direct and indirect taxation, I find the tax is valid as being "direct taxation within the Province."

With respect to discrimination, Justice Penny again rejected the applicants' arguments:

> "[121] The tax is a flat, annual rate based solely on the size, location and type of sign. The tax is payable by the owner of the sign in respect of that ownership. It is a fixed annual charge which does not vary with the amount of revenue the sign does or does not generate.
>
> [122] An owner of a ground sign displaying only static copy with an aggregate face area of 15 m2 or less (a Class I sign), would pay a tax to the municipality of $1,150 per year. That amount of tax would be payable no matter whether the revenue generated by the sign were $115,000 (equivalent to a tax of 1%), $16,428 (equivalent to a tax of 7%) or $5,750 (equivalent to a tax of 20%).
>
> [123] The fact that, in levying this tax of $1,150, the City was trying, or hoping, to approximate a tax of no greater than about 7% of revenue is irrelevant to whether the tax actually imposed is a tax on third party sign revenue. The City, in my view, is not

> doing indirectly what it cannot do directly. The tax, in its structure as an annual fixed rate based on sign size, type and location, avoids the prohibition in subsection 267(2) of the Act. It is not a tax on any person's "income, revenue, profits, receipts or other similar amounts."

With respect to discrimination by exempting the signs with which the City had a profit sharing agreement, the Court found as follows:

> [141] Subsection 10(1) of the Act specifically provides that any bylaw under the Act "may be general or specific in its application and may differentiate in any way and on any basis the City considers appropriate" [emphasis added]. In addition, section 267 of the Act, which authorizes the City to impose this tax, expressly authorizes the City to provide for "exemptions from the tax." This broad statutory authority to "differentiate" and to "exempt" in the exercise of the City's powers under the Act, in my view, means that the exemptions granted in section 771-8 of the Bylaw, including the exemptions granted to the City itself and to any sign owner who has entered into a revenue sharing agreement with the City, are within the City's powers as defined by the Act, so long as the City acted honestly and the steps taken were rationally connected to a legitimate municipal objective.
>
> …
>
> [146] The evidence is that the revenue shares paid to the City under the revenue sharing agreement significantly exceed the likely tax revenue that will be generated under the Bylaw. The evidence is also that the effect of imposing the Bylaw on signs subject to the revenue sharing agreement would be revenue neutral to the City and would merely result in shifting some of the revenues of the Street Furniture program to the Sign Tax program. In the circumstances, therefore, the City had a perfectly legitimate reason for exempting from the Bylaw sign owners with whom the City was already in a revenue sharing agreement. Acting on its statutory power to differentiate and to exempt while enacting this Bylaw, therefore, was not discriminatory.
>
> [147] OMAC's submission that, by imposing an allegedly onerous tax, the City was trying to force Toronto signs out of business, cannot, in my view, be sustained on the evidence. Rather, the evidence suggests that the City believed, rightly or wrongly, that the Bylaw established a tax model that would "not unduly burden the owner of any particular sign." The City's evidentiary record provides, in my view, ample support for the proposition that the City acted honestly and that the steps it took were rationally connected to legitimate municipal objectives. Accordingly, I also conclude that the Bylaw was not enacted for an improper purpose."

Justice Penny, however, did find for the applicants, OMAC that signs that existed prior to the effective date of the by-law were not subject to the tax. Justice Penny found that the sign tax by-law was a by-law relating to signs based upon jurisprudence regarding the meaning of the words "related to" and that it was clear that existing signs were not subject to the new sign tax by-law.

The Court of Appeal

The City of Toronto appealed that part of Justice Penny's decision that found that the signs are grandfathered. The applicants appealed the other aspects of Justice Penny's decision. The Court of Appeal upheld Justice Penny's decision on direct versus indirect, the tax on revenue and discrimination. However, it overturned his decision regarding the grandfathering, finding that section 110 of the *City of Toronto Act, 2006* was intended to apply only to regulatory by-laws as opposed to other by-laws which may affect signs.

The Supreme Court of Canada

OMAC and Pattison have sought leave to appeal of the Court of Appeal decision to the Supreme Court. Their lawyers have perfected, completed their appeals and submissions and a decision is expected shortly. The issues of national importance are framed as follows:

> "(i) *What is the proper legal test to distinguish direct versus indirect taxation?*
>
> The issue of what constitutes a direct versus indirect tax was last considered by this Court 14 years ago. Today, there are numerous tests, indicia and approaches to distinguish a direct tax from an indirect tax. The law must be clarified such that as municipal governments exercise their new taxing powers to expand tax revenues, direct/indirect taxation tests clearly define the limits of that taxation power. The Applicants propose a single test: looking at the specific tax in issue and considering its context and purpose, is it the general tendency of the tax such that it will be passed on?
>
> (ii) *Does a general authority to exempt from taxation authorize a municipal government to use its law making powers to create a competitive advantage for its joint ventures/shared enterprises?*
>
> In an era of expanding public-private partnerships, it is of national public importance whether a general power to differentiate and to exempt from taxation authorizes a municipal government to use its by-law making power to favour its own business interests to the detriment of private sector competitors.

(iii) *Whether a municipal government's taxation powers override Charter and statutory limitations on the municipal government's power to regulate signs?*

> The powers of a municipal government should not be read in a "generous fashion" in circumstances where a proposed sign tax will negatively impacts freedom of expression. The grandfathering clause in section 110 of the *City of Toronto Act, 2006* must be interpreted in a manner that best protects the Applicants' existing signs in accordance with section 2(b) of the *Charter*."

Should leave be granted, municipalities across Canada will have some definitive direction as to the extent of their authority to tax. If leave is not granted, the decision of Justice Penny and the Ontario Court of Appeal will provide guidance to municipalities in Ontario.

The essential issue, however, is the legislative restrictions on the imposition of taxes found in both the *City of Toronto Act, 2006* and the *Montreal Charter*. Given the expanding increase of responsibilities and costs upon municipalities, the provision of proper financial tools to raise the money that is needed for transit, water and sewers, roads and streets, etc. is crucial. The expanded taxing powers allowed to municipalities in the United States and the creation of the number of special project tax authorities is also illustrative. Unless and until provincial governments empower municipalities with their own authority to tax, including sales taxes, municipalities despite whatever might be downloaded from the provinces still remain creatures of the Province because of their financial reliance.

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