

A capital-gains tax would go far to cool Toronto's housing market

By Rhys Kesselman

April 10, 2017 – *The Globe and Mail*

Toronto's housing prices have escalated so sharply that the federal Finance Minister is seeking to consult on this crisis with his Ontario counterpart and the city's mayor. However, while mimicking policies adopted in British Columbia could be a stopgap to calm markets, addressing housing affordability will require bolder measures.

Prescribing remedies for economic problems will, as with medical maladies, be only as effective as the diagnosis. Developers and realtors have repeatedly cited a shortage of supply, which they attribute to constraints on zoning and approvals. While increased supply of appropriate housing will need to be addressed longer term, recent price inflation cannot be explained by the sudden emergence of supply shortages.

Like the spiralling prices in Metro Vancouver, Toronto's experience reflects a surge in demand that can only be described as speculative. The "speculators" include foreign buyers seeking refuge for their wealth, domestic investors and, yes, ordinary residents anxiously seeking their first home or moving up the home-ownership chain.

In this environment, every purchaser has become a speculator; at current prices, a person would be crazy to purchase without expecting or hoping for further appreciation.

This speculative process is abetted by record-low mortgage rates, but speculative motivations are further propelled by the absence of tax on the capital gains of resident homeowners. Slack enforcement by tax authorities has also facilitated evasion by others whose housing sales should be taxable even under current legislation.

Serial flippers who buy properties to renovate while residing in them and then sell are among those who escape tax on their gains. Foreign students who use their parents' wealth to acquire residential property to use while studying in Canada also can avoid the gains tax. Astronaut families living in upscale homes in different countries, with their breadwinner concealing their foreign earnings, can skirt both the gains tax and their income-tax liabilities.

Would a capital-gains tax on all home sales in the city, the province or even nationwide be a draconian response to these issues? The lack of such a tax is a major gap in the country's tax system, since all other incomes from business and investment (outside of registered plans) are taxable. This omission distorts the economy's savings toward excessive housing investment and away from productive business investment.

The lack of tax on home gains is also inequitable in its treatment of renters versus homeowners with similar wealth. Many people have made hundreds of thousands, others millions, in tax-free gains on homes in recent years based purely on good fortune. At the same time, others making far less through their labour are fully taxable on their earnings.

The design for a capital-gains tax on home sales could follow several principles. Gains accrued prior to the legislation's effective date would not be taxed; most would deem it inequitable to impose *ex post* taxation. However, if applied at appropriate rates, such a tax would powerfully dampen speculative psychology and thus housing demand.

The tax rate on gains should be set very high – even above 50 per cent – for homes owned two years or less. The rate should decline incrementally over the next 10 years of

ownership, perhaps reaching a rate of 20 per cent or lower after 12 years.

The cost base for computing taxable gains should allow for general inflation and outlays for major improvements, so that only the owner's real gain since enactment of the law would be taxed. In addition, the tax could allow each Canadian resident a lifetime exemption amount of gains, thus easing the movement to larger homes as a family grows.

If the federal authorities are not willing to act on taxing home gains, Ontario and/or Toronto could fill that void and use the proceeds to eliminate their heavy land-transfer taxes.

Housing affordability would be better served by relieving homeowners when they buy and recouping revenues when they sell.

Implementing a capital-gains tax on all home sales would go far toward restoring housing affordability by reducing the speculative motivation in housing demand. It also would revive the notion that home ownership is primarily for the benefits of enjoying secure occupancy.

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