



**ISSUE PAPER:**  
**BRITISH COLUMBIA ASSESSMENT**  
**CLASSIFICATION OF BED & BREAKFAST PROPERTIES**

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**Issue**

The British Columbia Assessment Authority (B.C.A.) has begun a process of reclassifying bed and breakfast accommodation in the province. Reclassification will result in property tax increases of two to four hundred percent.

**Purpose of the Issue Paper**

This paper assembles information relevant to the issue for the purpose of discussion and draws conclusions based on this information. Recommendations for action to enable changes in legislation and defence of those re-classified is contained in the Western Canada Bed & Breakfast Association document *WCBBIA/Birchard/BCAA9-01*.

**Background**

In 2000 a paper entitled *Property Tax Classification of Short Term Overnight Commercial Accommodation Properties (STOCAP)* was prepared by the B.C. Assessment Authority at the request of the then Ministry of Municipal Affairs. The Committee Members who prepared the report included two employees of the Corporate Policy Branch of the Ministry of Municipal Affairs and three employees of the B.C. Assessment Authority.

An issue surrounding property taxation of strata complexes, particularly in Whistler, caused the committee to be formed and the paper to be written. In the 1995 taxation year a new section was added to taxation regulations specifically to deal with 'strata hotels'. This new regulation meant that these hotels were moved from Class 1 (Residential) to Class 6 (Business and Other), the same classification used for conventional hotels or motels.

Over the next few years, several large strata complexes restructured their management arrangements to meet the requirements for residential classification; this movement of one type of accommodation properties between classifications was of significant concern to affected taxing jurisdictions, owners of conventional hotels that were competing in the same market place and individual owners in the affected strata units. The Mayor of Whistler requested that the classification issue be addressed and the then Minister of Municipal Affairs agreed. The *Property Tax Classification* paper was the result.

The paper stated that the issue of STOCAP classification had become unclear and unstable because:

- "instability in classification hurts both taxing jurisdictions and taxpayers -- taxing jurisdictions cannot count on a stable stream of tax revenues when property classifications are volatile;
- "business planning is impossible when tax burdens fluctuate over time."

The paper noted that taxing jurisdictions and property owners had made the following criticisms regarding assessment and classification of accommodation properties:

- "the *whole system* is unfair in that valuation and classification can compound and place some properties at a distinct competitive disadvantage
- "the system of *taxation* is unfair because sometimes vastly different tax rates are assigned to properties that are playing a similar role in the accommodation sector;
- "the system of *valuation* is unfair in that different approaches to valuation may be taken for conventional accommodation properties;
- "the system of *classification* is unfair because in many respects it permits similar properties to be taxed differently."

The paper focused on the classification of STOCAPs, not ancillary issues such as valuation and taxation. Its main purpose was to address issues surrounding the

classification of stratified accommodation properties, but in so-doing it also entered the realms of bed & breakfasts, time shares, privately owned cabins or homes rented to tourists, 'virtual hotels' and banks of rooms rented in conventional hotels for long periods of time.

### Classifications

Two classifications can apply to properties used for accommodation purposes:

- Class 1 -- residential: for properties used for residential purposes (includes single-family residences, multi-family residences, duplexes, apartments, condominiums, nursing homes, seasonal dwellings, manufactured homes, recreational property, some vacant land, farm, buildings and daycare facilities), and specifically does not include:
  - hotels or motels other than the portion...occupied by the owner or manager as his or her residence;
  - 20 or more strata lots that are (a) on one parcel or contiguous parcels, (b) used for overnight accommodation, and (c) controlled or managed by persons...who control or manage 85% or more of the strata lots on the parcel, that are (d) offered for rent, or rented, for periods of less than 7 days...as overnight accommodation for at least 50% of the 12 month period....
- Class 6 -- business and other: for all properties not falling within other classifications, including offices, retails, warehousing, hotels and motels (except for any portion occupied by an owner or manager as a residence).

### Policy

The current B.C. Assessment Authority policy provides that if a bed & breakfast contains four or more rooms (or units), which are available for rent for at least six months of the year, then those rooms plus any other part of the bed and breakfast used for purposes ancillary to those overnight rentals will be classified as Class 6.

The criteria of four units was selected to be consistent with the Hotel Room Tax Act (HRT) because that is the number of rooms that are necessary for the HRT Act to apply to the property.

Portions of the B&B not used to provide overnight accommodation to guests remain in Class 1 -- residential.

A June 28, 2001 memorandum of B.C.A.'s Valuation Steering Committee was intended "To provide Area office staff with consistent direction on the classification of Bed and Breakfast (B&B) accommodation." It states that "B&B operations have grown in numbers and sophistication over the past 10 years. In some resort areas of BC, B&B operations compete directly with the conventional hotel-resort industry. To ensure equity of classification between larger B&B operations and other non-home based accommodation operations, the (committee) has developed a classification policy.

"This policy applies to B&B accommodation operations:

- with 4 or more units
- offered for rent, or rented, for periods of less than 7 days to persons, or a person, as overnight accommodation for at least 50% of the 12 month period ending on October 31 of the year during which the assessment roll is completed.

"This policy does not apply to the strata units offered for overnight accommodation."

The memorandum includes the following explanations:

- "B&B Operation. A Bed and Breakfast (B&B) operation is analogous to 'mini-hotel' with the owner/manager residing on the premises. While there are many variations of B&Bs, most are based on a single family dwelling, demised physically or functionally into space for guest and owner/manager use. In the case of a mini-hotel, the owner does not normally reside on the premises and the entire property would be Class 6.
- "De Minimus Rule. According to Black's Law Dictionary this common law principle is based on the premise that 'the law does not care for, or take notice of, very small or trifling matters.' In other words, a measure of common sense is required to determine whether a B&B is significant enough to warrant a split classification.
- "Unit. For the purpose of this policy, a unit in a B&B operation is a separate bedroom offered for guest overnight use. In the interests of simplicity and consistency, the number of beds in a bedroom is not a consideration."

The memorandum instructs assessors in determining if a portion of the B&B accommodation should be classified as Class 6 - Business and Other, and if there should be a split between Class 1 -- Residential and Class 6 -- Business and Other. The following key steps are advised:

- "1. Does the B&B offer 4 or more units (beds) for overnight accommodation?  
If *no*, classify as Class 1; if *yes*, go to step 2. Rationale: consistent with Hotel Room Tax Act definitions and application of the De Minimus Rule.

2. Does the owner reside on the premises? If *no*, classify as Class 6; if *yes*, go to step 3. Rationale: this type of mini-hotel should already fall into Class 6.
3. Does the B&B offer overnight accommodation for periods of less than 7 days, for more than 50% of the 12 month period ending on Oct 31<sup>st</sup> of the year the roll was produced? If *no*, classify as Class 1; if *yes*, B&B should be Class 1-6 split. Rationale: approach consistent with Short Term Overnight Accommodation Policy proposal."

The memo gives direction to the assessor on applying a split classification.

- "1. Identify number of units used for overnight accommodation as a percentage of the total number of units. Rationale: ease of administration. It is reasonable to assume land contributes to property utility on a similar basis for business and residential use.
2. Apply percentage ratio to value of land and buildings (pro-rata approach) to arrive at amount of land and improvements subject to Class 6 and Class 1. Rationale: based on assumption that clients of B&Bs will normally use common areas in a residence such as living room, den, hallways, parking and grounds.
3. Exception to the pro-rata basis for classification should be situations where 'exclusive B&B' areas (e.g. guest parking, guest kitchen, guest lounge etc) can be clearly identified. These areas should be Class 6."

The memo also discusses Valuation. "The valuation approach for B&B properties should be based on the way in which these properties trade on the market. In most cases, B&Bs will trade on the basis of value in exchange rather than as an income producing property.

"Appraisers should be aware that in many cases, B&B properties have superior finishing and quality of features. B&Bs are also increasingly 'purpose built' structures with specific design features, such as commercial quality kitchens, larger than typical dining areas, clearly separated guest and owner use areas, and additional baths."

### **The Assessment/Taxation Process**

There are three components to the property tax system affecting the amount of tax paid by a property owner. The market drives the choice of approach and, ultimately, the assessed value.

Valuation. A determination of the market value of all real property is annually made by the Assessment Authority. Property tax applies only to the value of land and buildings. For assessment purposes, market value is the most probable price for which a property would sell on the open market on July 1 of the year in which it is assessed.

There are three principal approaches to property valuation:

1. Direct Comparison -- the value of a property determined by looking at market sales of comparable properties, an approach most appropriate when the market is active and many properties with similar characteristics are selling.
2. Cost -- the value of a property based on an estimate of the land value plus the cost of replacing or reproducing the building on the site (less depreciation on the building), an approach used most often when the property is new, there are no comparable sales or the improvements are unique.
3. Income -- the value of the property is directly related to the income it will generate over its economic lifetime, an approach widely used when appraising income producing properties.

When there is sufficient market activity and market data, properties are valued using at least two of these approaches and results are then reconciled.

Properties used for accommodation purposes are typically valued using either the Direct Comparison or the Income approaches, with the assessor using discretion to determine which approach to valuation is most appropriate. Additionally, if an accommodation property is stratified, the assessor must further determine whether the property would likely sell as an individual unit (i.e., there is a market for individual units) or whether it would sell only as part of a complex (i.e., there is no market for individual units).

The requirement in all cases is to determine market value.

Classification. In addition to valuing real property, the assessor also classifies property within the nine classifications set out in the Regulation. Definitions used in classifying residential and business use are discussed elsewhere in this paper.

Tax Rates. Tax authorities determine the rates they wish to apply to each property class in their jurisdiction. This system is known as variable rate taxation. The setting of these rates establishes the distribution of property taxes between classes. The application of the rates, by class, to the assessed value in that class results in the tax revenues used to provide services such as transportation, schools, public health, police and fire protection, water, sewer systems, etc. The rates that are applied are within the discretion of the taxing jurisdiction. Typically, business rates are higher than residential and are a multiple of residential. For example, in 1999 Prince

George's business rate was 1.5 times its residential rate and Vancouver's was 5.2. The rates vary widely between jurisdictions.

### Definitions

Case law and dictionaries are the guides used by B.C.A. in defining terms used in the classification process.

- The courts have held that property is used for residential purposes "when people reside in it or if it is being used for purposes which ... are of a kind normally ancillary to use for residential purposes e.g. lawns, gardens, tennis courts and the like."
- The Oxford Dictionary defines "residential" as "suitable for or occupied by private houses" or "used as a residence". "Residence" is then defined as "the place where a person resides; an abode". It further defines "reside" as "have one's home; dwell permanently". An abode is "an habitual residence; a house or a home". A home has a number of definitions, but the most common are "the place where one lives; the fixed residence of a family or household" and "a dwelling house".

"Residential" connotes a sense of reasonable permanence of occupation. By comparison, the same dictionary defines a "hotel" as "an establishment providing accommodation and meals for payment". This definition suggests that hotels provide accommodation of a more transitory and commercial nature than residences.

Based on these definitions, Class 1 -- Residential specifically includes single family homes, duplexes, apartments, nursing homes, summer cabins and bunk houses.

Specifically excluded from Class 1 are hotels and motels (except for the portion used by the owner or manager as a home), penitentiaries and hospitals. All of these, therefore, fall into Class 6 -- Business and Other.

The B.C. Assessment also considers that properties used for hotel or motel purposes typically share features that can be divided into three main categories:

- "**Physical attributes**: they include a lobby, front desk, secure sleeping rooms, private bathrooms, individual heat controls and telephones on the premises;
- "**Amenities**: they provide daily housekeeping services, an on-site owner or manager, on-site services such as wake-up calls, front desk attendants and other general guest services. Dining facilities may also be provided;
- "**Management arrangements**: usually they have a resident manager or owner but may have a non-resident manager. They normally advertise facilities as being available for the purpose of overnight accommodation; they may be listed in the yellow pages, in the BC Tourist Accommodation Guide and have a sign advertising that they are a hotel, motel or other entity with overnight rooms available." Additionally, B.C.A.A. notes that hotels and motels are typically subject to the Hotel Guest Registration Act and/or the Hotel Keepers Act and/or the Hotel Room Tax Act. (The Hotel Room Tax is described by the Taxation Branch as the 'Hotel/Motel/B&B Room Tax'.)

### Zoning and Licensing

Zoning and Licensing are municipal issues and, although they don't really have a place in this paper, they confuse the assessment process for many people. An explanation of each has been included here as an aid in clarifying.

The Random House Dictionary defines *zone* as "an area or district in a city or town under special restrictions as to the type of buildings that may be erected" and "any continuous tract or area...which differs in some respect, or is distinguished for some other purpose, from adjoining tracts or areas or within which certain distinctive circumstances exist or are established".

Municipalities and cities usually divide land within their boundaries into such zones as 'single-family', 'multi-family', 'retail/commercial', 'service commercial', 'light industrial', 'heavy industrial' and the like.

Random House defines *license* as "formal permission from some constituted authority to do something, as to carry on some business, profession, etc."

The British Columbia Municipal Act names certain uses for zones; 'bed and breakfast' is not included among those named as permitted in single-family zones. In the absence of this inclusion, it falls to the individual municipality or city to issue special permits by means of bylaws if it wishes to make bed and breakfast accommodation available.

In recent years several municipalities and cities have developed such bylaws. The following are examples of four entirely different sets of regulations. Many others exist.

City of Vancouver. A simple business license is available to operate a bed and breakfast to a maximum of two rooms in a single-family zoned area.

City of Victoria. No license is required to operate a bed and breakfast to a maximum of two rooms; to operate in excess of two rooms the property must be zoned with the number of transient accommodation rooms registered against the title

of the property; to operate with more than four rooms all fire safety requirements of the National Building Code must be met.

Municipality of West Vancouver. A simple business license is available to operate a bed and breakfast to a maximum of two rooms *if the business existed prior to adoption of a certain bylaw in 1999*. Subsequent to this adoption a new bed and breakfast may operate, under license, only in a single-family zoned area specifically re-zoned to include bed and breakfast as a permitted use.

District of North Vancouver. A simple business license is available to operate a bed and breakfast to a maximum of three rooms in a single-family zoned area. A higher-level license to a maximum of six rooms may be applied for and is subject to a public meeting process, specific approval by the municipal council and the property meeting fire safety requirements of the National Building Code.

The assessment system recognises *zones* through the valuation process. Comparisons of market values are conducted by B.C.A.A. within the same zone.

Licenses are not considered by B.C.A. The fact that a municipal license is issued to the owners of property and not to the property itself is not recognised as relevant.

#### **Classification of STOCAPs in Other Provinces**

The Provinces of Manitoba, Saskatchewan, New Brunswick, Nova Scotia, Yukon, Ontario and Prince Edward Island all reported to the STOCAP committee that the classification of properties used for commercial accommodation purposes had not been a significant concern in their jurisdictions. Each of these provinces classifies hotels and motels as a form of commercial property as distinct from residential property. In PEI the sleeping rooms in hotels are classified as residential and the rest of the hotel as commercial.

Ontario relies on a definition of 'hotel' found in its Registration of Guests Act. "Hotel means a separate building used for the purpose of catering to the needs of the travelling public by the supply of food and also by the furnishing of sleeping accommodation of not fewer than six bedrooms as distinguished from any other building or connected buildings used mainly for the purpose of supplying food and lodging by the week or otherwise commonly known as 'boarding houses' or of furnishing living quarters for families and having a dining room or restaurant commonly known as 'apartment houses' or 'private hotels'. Ontario's Room Services Tax Act requires collection of tax by establishments with four or more rooms: 'This includes bed and breakfast establishments'.

In 1998 Nova Scotia amended its Assessment Act by adding a definition for Bed and Breakfast: "...means a private home in which the owner resides and provides accommodation to the travelling or vacationing public of a maximum of four bedrooms and a common living room and serves breakfast of which the cost is included in the price of accommodation". "...a bed and breakfast establishment shall be assessed as a residential property".

#### **Other Statements by B.C. Assessment**

In recent reports and statements, various representatives of B.C.A. have said that the reclassification of bed and breakfast operations has come about "because of complaints from the hotel industry", because they have had "challenges from people in the hotel and motel industry", that this action is "business as usual" and that "all home-based businesses will be looked at for reclassification".

#### **Tourist Accommodation (Assessment Relief) Act**

This Act offers a measure of tax relief to eligible tourist accommodation properties in Class 6 -- Business and Other. All properties used to provide overnight accommodation to guests are eligible.

The Act allows for a reduction of the assessed value of an eligible property by the smaller of the following amounts:

- "(a) \$150,000 less 15% of the amount by which the assessed value is over \$2,000,000;
- "(b) 50% of the assessed value."

The Act provides a different formula for applying a reduction to strata lots in a strata plan.

#### **Issue Summary and Comments**

- The reclassification of bed and breakfast properties will affect a significant proportion of B&Bs in British Columbia in the short term and all bed and breakfast properties in the longer.

The present B.C.A. policy calls for the re-classification of B&Bs of four and more rooms, but this policy is subject to constant review and a currently-held interpretation of the Act.

- The Regulation under which the B.C. Assessment is presently reclassifying properties is based on a proposal paper published in 2000 and findings resulting from that paper.

- The proposal paper was initiated by the Ministry of Municipal Affairs in response to a municipal request for a ruling on the short-term rental of stratified properties.

The paper only secondarily touched on other forms of short-term accommodation such as bed and breakfast establishments.

- The minimum number of units (four) is set by B.C.A. to match the number contained in the Hotel Room Tax Act.

The Hotel Room Tax Act was not adopted to define 'hotel', but to initiate and regulate a system for setting and collecting tax revenue.

The Hotel Room Tax Act defines 'accommodation' as the provision of lodging. In the Hotel Room Tax Regulations 'accommodation' does not include that 'provided by an operator who offers less than 4 units of accommodation.'

It may be assumed, therefore, that the number of rooms in Classes 1 and 6 is adjustable upwards or downwards as a result of future studies by B.C.

Assessment. This opinion is strengthened by statements of B.C.A. that it plans to investigate and evaluate for reclassification purposes all home-based businesses in the province, not just B&Bs of four and more rooms.

- The STOCAP paper and other documents refer to property tax inequities created by some accommodation providers in Class 1 and others in Class 6, all competing in the same market.

If an inequity presently exists between some hotels and some larger bed and breakfasts, reclassification of the latter will create an even greater inequity between larger and smaller bed and breakfasts. Issues of 'unfairness' remain as when the STOCAP paper was written.

- B.C.A. has stated that a premium is paid by purchasers to vendors of B&Bs

This opinion is flawed. With relatively few exceptions, B&Bs operate under municipal license, not as specially zoned properties. Licenses are issued annually and are not attached to the property. They must be renewed by subsequent owners and do not, therefore, add to the property's market value.

- B.C.A. has stated that 'in many cases, B&B properties have superior finishing and quality of features'.

This appears to relate B&Bs to either hotels/motels or to other single family dwellings. The majority of B&Bs, regardless of their size, are single family dwellings and, as such, generally have superior finishes and features to those found in hotels and motels. Regardless, the statement confuses Classification and Valuation.

- B.C.A. considers that hotels/motels share certain features.

These are not typically present in a B&B regardless of its size: front desk and attendants, individual heat controls, full-service restaurants, for example. Without appropriate zoning, a B&B may not obtain a liquor license, making it considerably different from a hotel in the mind of the travelling public.

- The Act considers as Class 1 -- Residential, fewer than 20 strata lots on one parcel of land used for overnight accommodation.

In other words, a nineteen suite condominium building may employ a manager and rent all its suites on a daily basis and still be classed as Class 1 -- Residential, but a four-room bed and breakfast residence is classified as Class 6 -- Business.

- The Tourism Accommodation (Assessment Relief) Act provides tax relief for all providers of tourism accommodation in Class 6.

The Act only partially recovers additional property tax levied by reclassification, is a movement of funds from one 'pocket' to another and does not address the issue of inequity created by the reclassification of a portion of the bed and breakfast industry.

Unlike Hotel Room Tax, which is charged to guests as an add-on to room tariff, property tax is an overhead item -- a cost of doing business. It may either be absorbed by the operator, thereby reducing profitability, or it may be passed on to guests.

If profitability is reduced as a result of a property tax increase for some but not all, an inequity exists and the tax is an unfair tax.

Increases in prices resulting from increases in taxes for some but not all can result in (a) a smaller market share for the operator with higher prices or (b) no alteration in market share regardless of the increased price.

If the market share alters downward for some but not all as a result of tax-caused price increases, an inequity exists and the tax is an unfair tax.

If the market share does not alter as a result of increased prices, the tendency is for other operators providing similar services to increase their prices, as well. If this produces a higher profit margin for some, but not all, an inequity exists and the tax is an unfair tax.

B.C.A. is conducting its present re-classification of bed and breakfast properties in grey areas of the Act and its Regulations and within the terms of its mandate. Short-term relief to those who are re-classified may be available on appeal, but the undefined area will remain until new legislation is adopted. A cohesive effort on the part of all B&B operations in British Columbia, regardless of size, can cause government to address the inequity issue and recognise bed and breakfasts as Class 1 -- Residential.

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