Abstract

Using transaction records on housing sales and leases, we estimate the effect of Toronto’s imposition of a land transfer tax in 2008. We find two novel effects of an increase in land transfer tax: (1) a rise in buy-to-let transactions but a fall in owner-occupier transactions despite the tax applying to both, (2) a simultaneous fall in the price-to-rent ratio and the sales-to-leases ratio. We develop a housing search model with both ownership and rental markets to show that the land transfer tax can generate lock-in effects both within the ownership market and across the two markets. It accounts for the two new facts by predicting a reduction in mobility within the ownership market and an increase in demand in the rental market which generates a fall in the homeownership rate. The implied deadweight loss as a percentage of tax revenue raised is large, with more than one-third due to distortions across the two markets.