



2019 Pre-Budget Submission

House of Commons Finance Committee

August 2, 2018

Recommendations

- **Recommendation #1:** To prevent the further spread of illegal tobacco, amend proposed Tobacco Products Regulations for plain and standardized packaging and products to allow some means to differentiate legal from illegal tobacco products.
- **Recommendation #2:** To better combat the illegal tobacco trade, ensure the federal excise stamp has track and trace features.
- **Recommendation #3:** Establish a Federal-Provincial-First Nations task force to address illegal tobacco manufacturing, sales and trafficking, with meaningful input from law enforcement and the tobacco industry.
- **Recommendation #4:** Adopt a harmonized federal-provincial fiscal approach for reduced harm products based on their relative risks and the precedent set with cannabis.

INTRODUCTION

The facts surrounding Canada's illegal tobacco trade are stark:

- A market share of 20-25% nationally and close to 40% in Ontario.¹
- Annual tax losses of \$1.5-2 billion and cumulative losses of \$19.5-26 billion since 2006.²
- Vast amounts of money diverted to organized crime groups with indisputable links to other criminal activities.³
- Undermined profitability for thousands of law-abiding small business owners who sell legal tobacco products, in some cases forcing them to close.

With the consultation theme of economic growth and competitiveness, we are forced to ask how billions in lost tax revenue, undermining law-abiding licensed tobacco retailers, and the enrichment of organized crime are benefiting Canada in any way. Worse still, the Government is poised to make the situation much worse.

The silver lining is that the Government still has the potential to get it right when it comes to reduced harm products like vaping and tobacco heated products (THP).

ABOUT IMPERIAL TOBACCO CANADA LIMITED (ITCAN)

Established in 1908, ITCAN is Canada's leading tobacco company. Headquartered in Montreal, ITCAN employs approximately 450 people across Canada.

ITCAN is dedicated to conducting its business responsibly, in a manner that meets society's expectations of a 21st century tobacco company. ITCAN recognizes the health risks associated with tobacco consumption and believes underage people should not consume tobacco products. We support reasonable and evidence-based regulation, especially those aimed at keeping tobacco products out of the hands of youth.

ITCAN strictly follows all laws and regulations that govern the tobacco industry and pays all required taxes. Unfortunately, the Canadian tobacco market is being tainted by an illicit trade – and those who sell illegal tobacco abide by a completely different set of rules.

ILLEGAL TOBACCO IS THRIVING – AND MAY GET MUCH WORSE

The current contraband tobacco market results primarily from illegal manufacturing, which involves 50 illegal cigarette factories and approximately 300 smoke shacks located on First Nations territories. The illegal tobacco is trafficked across Canada and sold outside existing legal, regulatory and tax frameworks by 175 groups which have ties to organized crime.⁴ Federal and Provincial Governments lose upwards of \$2 billion in tax revenue annually as a result.⁵ The RCMP acknowledges the growth of the industry and has drawn the link between illicit tobacco and other criminal activities.⁶

¹ <http://ontariocstores.ca/2017contrabandstudy/>

² Estimate based on average annual losses of \$1.5-2 billion since 2006.

³ See report from W5, <https://www.youtube.com/watch?v=4nJLuXVizaY>

⁴ RCMP testimony to the House Public Safety and National Security Committee, April 27, 2010

⁵ Estimate based on the level of illicit trade in 2010 from GFK Research and PTT Revenue sourced from Government budget documents (government Year-end March 31st, 2010).

⁶ <http://www.rcmp-grc.gc.ca/ce-da/tobac-tabac/index-eng.htm>

Other than Quebec, where coordinated enforcement efforts have been in place for several years, the illegal market is thriving, particularly in Ontario. According to data from the Ontario Convenience Stores Association, the illegal tobacco rate in the Province is up 67% from three years ago, growing from 22.3% in 2014, to 24.6% in 2015, 32.8% in 2016 and 37.2% in 2017.⁷ Rates in Atlantic Canada are in the 15-20% range.⁸ They are lower in Western Canada, ranging from 10-15%, but have been trending upwards.⁹

Unfortunately, the Government is poised to make the situation much worse with plans for plain and standardized packaging of tobacco products, and the standardization of cigarettes themselves, making it virtually impossible for consumers, retailers and law enforcement to tell a legal from an illegal product.

Further complicating matters is that the draft regulations for this legislation seek to impose the pack (“slide-and-shell”) and cigarette (plain white with a cork or white filter tip) formats that are most common on the illegal market, rather than the global pack standard (“flip top”) that is not readily available in the illegal industry, or allowing functional design features on cigarettes (e.g. on the filter) for which there is no evidence the illegal operators can match.

The net effect is massive compliance costs on the legal industry to re-engineer its manufacturing process to match the pack and stick formats of the illegal operators, while simultaneously greatly increasing the potential for expanding Canada’s existing contraband tobacco problem to include counterfeit products, since legal products will be easy to copy in a plain and standardized pack and stick environment.

Recommendation #1: To prevent the further spread of illegal tobacco, amend proposed Tobacco Products Regulations for plain and standardized packaging and products to allow some means to differentiate legal from illegal tobacco products.

Further complicating matters, the Government’s tobacco excise stamping system has been compromised, with legitimate stamps routinely appearing on illegal packaging. This issue takes on far more importance in a plain and standardized environment because Health Canada claims the stamp will give consumers assurance that a product is legitimate.

A compromised excise stamping system makes it even more challenging to distinguish legal from illegal products. To address this, a new stamping system is needed that allows consumers, retailers and law enforcement to access built-in features that give more information about the product and its origins. This technology is in place in other markets and has to be implemented in Canada before plain packaging takes effect. Unfortunately, a recent RFP from the Canada Revenue Agency for the stamping contract does not mandate such features.

⁷ <http://ontariocstores.ca/2017contrabandstudy/>

⁸ See <http://theacsa.ca/2016/convenience-store-retailers-support-crackdown-on-illegal-tobacco-sales-in-new-brunswick/>, <http://theacsa.ca/2016/illegal-cigarette-sales-in-nova-scotia-too-high/>, and

<http://www.southerngazette.ca/news/local/2016/11/29/illegal-cigarettes-still-common-in-n-l.html>

⁹ See <http://www.marketwired.com/press-release/illegal-tobacco-rate-climbs-in-manitoba-2171475.htm>,

<http://www.marketwired.com/press-release/saskatchewan-maintains-lowest-illegal-tobacco-rate-2171998.htm>,

<http://www.newstalk770.com/2016/11/03/illegal-tobacco-use-at-over-12-in-alberta-study/>, and

<http://www.cbc.ca/news/canada/british-columbia/illegal-smokes-a-big-problem-in-b-c-says-study-1.3853311>

Recommendation #2: To better combat the illegal tobacco trade, ensure the next federal excise stamp has track and trace features.

Finally, federal leadership in fighting illegal tobacco is still lacking. Given the significant threat that plain packaging will lead to a large expansion of the illegal tobacco trade, it is beholden upon the Government to develop a comprehensive plan to deal with this persistent problem.

Recommendation #3: Establish a Federal-Provincial-First Nations task force to address illegal tobacco manufacturing, sales and trafficking, with meaningful input from law enforcement and the tobacco industry.

REDUCED HARM PRODUCTS: AN OPPORTUNITY

There are currently three main types of tobacco and non-therapeutic nicotine products:

- Traditional cigarettes and loose tobacco, which involve the combustion of tobacco and the inhalation of smoke;
- Vaping products like e-cigarettes, which have no tobacco or combustion and produce a vapour that is inhaled;
- Tobacco heated products (THP), which heat a tobacco stick and produce vapour with no combustion.

When placed on a risk spectrum, traditional cigarettes are the most harmful and vaping products the least, with THP falling in between. An appropriate legislative, regulatory and tax framework is critical if these products are to fulfill their public health potential, which has been brought to the public's attention largely by recognized public health advocates.

For example, in 2016 the U.K. Royal College of Physicians ("RCP") released a report that recommends "in the interests of public health it is important to promote the use of e-cigarettes, NRT [nicotine replacement therapy] and other non-tobacco nicotine products as widely as possible as a substitute for smoking." The RCP also stated that e-cigarettes are not a gateway to smoking; that use is confined almost exclusively to those who are using or have used tobacco; that vaping does not "normalize" smoking; that there is no evidence that non-smokers and youth are drawn to e-cigarettes and will end up smoking as a result; and that for many people e-cigarettes are an effective smoking-cessation tool.¹⁰

This RCP report echoed the findings of Public Health England ("PHE") whose evidence, published in 2015, concluded that "best estimates show e-cigarettes are 95% less harmful to your health than normal cigarettes;" that nearly half the population does not realize e-cigarettes are "much less harmful than smoking"; there is no evidence that e-cigarettes are acting as a route into smoking for youth or non-smokers; and e-cigarettes may be contributing to decreasing smoking rates among adults and young people. PHE's Director of Health and Wellbeing emphasized that e-cigarettes "carry just a fraction of the harm" associated with smoking.¹¹

¹⁰ <https://www.rcplondon.ac.uk/projects/outputs/nicotine-without-smoke-tobacco-harm-reduction-0>

¹¹ <https://www.gov.uk/government/news/e-cigarettes-around-95-less-harmful-than-tobacco-estimates-landmark-review>

An update on the PHE report was released last February.¹² Its main findings are as follows:

- Vaping poses only a small fraction of the risks of smoking and switching completely from smoking to vaping conveys substantial health benefits;
- E-cigarettes could be contributing to at least 20,000 successful new quits per year and possibly many more;
- E-cigarette use is associated with improved quit success rates and an accelerated drop in smoking rates across the country;
- Many thousands of smokers incorrectly believe that vaping is as harmful as smoking, and around 40% of smokers have not even tried an e-cigarette;
- Less than 10% of adults understand that most of the harms to health from smoking are not caused by nicotine;
- The evidence does not support the concern that e-cigarettes are a route into smoking among young people. Youth smoking rates in the UK continue to decline. Regular use is rare and is almost entirely confined to those who have smoked.

Finally, the University of Victoria released a comprehensive study of e-cigarettes in January 2017.¹³ Based on its findings, the authors recommended that “Canadian regulations of vapour devices be informed by the best available evidence and with a view to improving public health; that more accurate information about their risks in comparison with tobacco use is provided to the public; and that strategies are developed to help people who wish to quit smoking have affordable access to the safest forms of vapour devices.”¹⁴

For consumers to take advantage of reduced harm products, they need to be accessible and affordable. To that end, it makes no sense to impose additional taxes on products that are potentially less harmful than combustible cigarettes. Instead, taxation should be based on relative risks.

Finally, it is important to note the parallels in the market for these new potentially reduced harm products and cannabis. With the latter being a “new” market, the Federal Government implemented a coordinated tax regime with the provinces to ensure the migration of consumers to the legal market. Until the passage of federal legislation in May, most vapour products with nicotine sold in Canada were illegal.¹⁵ Therefore, using the same logic applied to cannabis would be prudent to encourage smokers to migrate to the legal market.

Recommendation #4: Adopt a harmonized federal-provincial fiscal approach for reduced harm products based on their relative risks and the precedent set with cannabis.

¹² <https://www.gov.uk/government/news/phe-publishes-independent-expert-e-cigarettes-evidence-review>

¹³ <https://www.uvic.ca/home/about/campus-news/2017/e-cigarettes-carbc-macdonald-stockwell+media-release>

¹⁴ Ibid.

¹⁵ The exception was some nicotine replacement therapy products.

CONCLUSION

The recommendations offered are designed to prevent the further growth of Canada's illegal tobacco trade, to begin to reduce the size of its market share, and to recoup billions in lost tax revenue. At the same time, the Government can establish an appropriate fiscal regime for reduced harm products that reflects the relative product risks to encourage smokers to migrate from combustible cigarettes to these alternative sources of nicotine in support of public health policy objectives.