

**Written Submission for the Pre-Budget
Consultations in Advance of the 2019 Budget**

By: Rothmans, Benson, & Hedges Inc.

Recommendation: That the government amend the Excise Act, 2001 in order to create a new category for heated tobacco products (HTPs)

Issue:

Under the current federal tobacco tax framework, no specific category exists to capture the unique nature of Heated Tobacco Products (HTPs) – products that heat tobacco without burning it to release a vapor with substantially less harmful toxicants compared to cigarettes and other smoking tobacco products.

Recommendation:

Rothmans, Benson & Hedges recommends that the government amend the Excise Act, 2001 in order to create a new category for heated tobacco products (HTPs). This will modernize Canada's tobacco tax framework to facilitate appropriate taxation and tax administration of novel heated tobacco products, consistent with the Government of Canada's goal of reducing smoking rates to 5% by 2035.

The current tax framework has the (unintended) consequence that a pack of 20 HTP sticks are subject to up to 3 times higher levels of Federal Excise Duty (FED) compared to a pack of 20 cigarettes. This goes counter to the notion that products should be taxed in line with the risk they pose. A new tax category would enable the government to differentiate between the tax levels of HTPs and combustible tobacco products and thereby enable a risk based approach to tobacco taxation. By creating a HTP tax category, Canada will mirror the approach taken by 23 other governments who have modernized their tobacco tax framework to include HTPs or are in the process of including HTPs such as the United Kingdom, Japan, and Italy.

About Heated Tobacco Products:

Heated tobacco products (HTPs) are designed and manufactured as smoke-free tobacco products with the aim of reducing the harm caused by smoking. HTPs are supported by a growing number of public health institutions and experts as a potentially less harmful alternative for legal age smokers who would otherwise continue to smoke. HTPs have been adopted by millions of smokers worldwide, and are currently available for sale in Canada. As the market for HTPs increases internationally, a modernized tax framework has been adopted by countries around the world to facilitate appropriate taxation of these novel tobacco products based on their characteristics.

Heated Tobacco Products and Risk:

It is widely recognized that the majority of risks and adverse health effects caused by smoking are not triggered by nicotine, but primarily by the toxic substances generated during tobacco combustion (burning).

Combustion occurs when the tobacco is ignited by a heat source, such as the flame from a match or a lighter. Once lit, a self-sustaining exothermic oxidation reaction is established at the tip of the burning cigarette with the temperature of the tobacco reaching around 600 °C (over 800 °C at the lit end when a puff is taken).

More than ten years ago, Philip Morris International - Rothman, Benson & Hedges' parent company, began research and development on a new heated tobacco product line

designed to provide smokers with a less harmful alternative to smoking cigarettes. This led to the development of *IQOS* and *HEETS*.

Exhibit 1: IQOS Components & HEETS

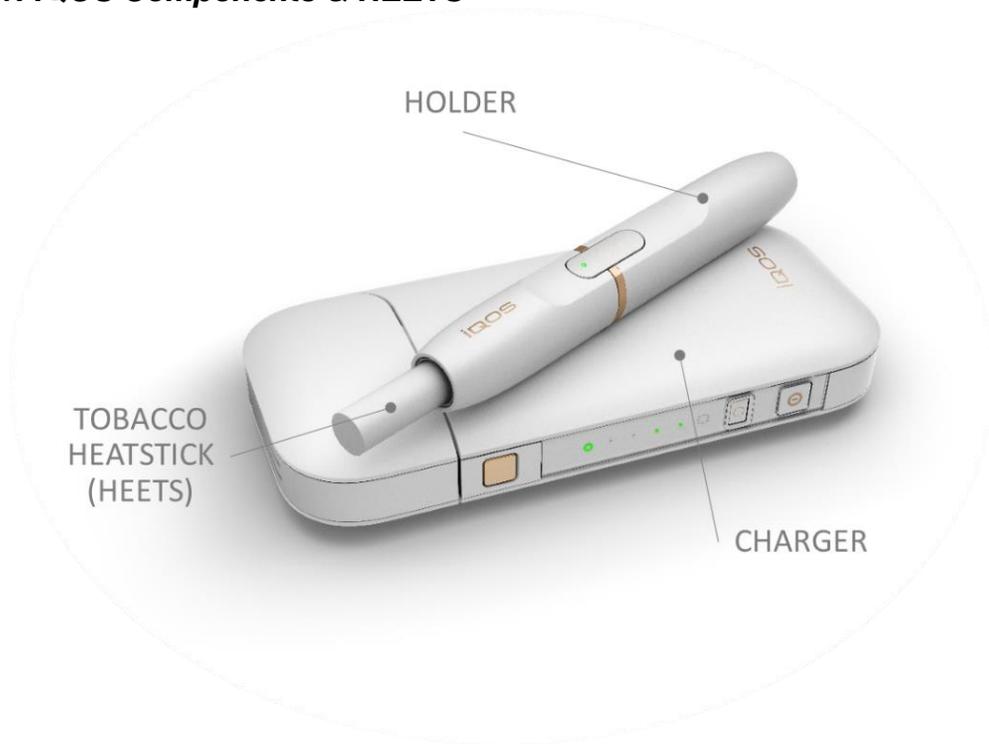
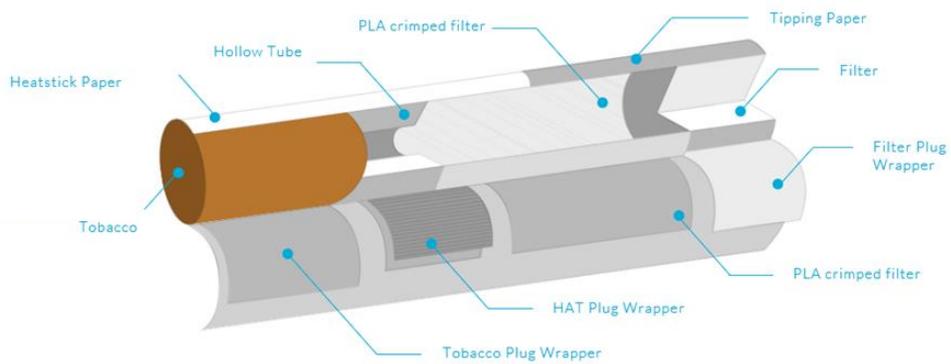


Exhibit 2: Holder and Heated Blade



Exhibit 3: HEET's Components



IQOS is an electronic device that consists of two components - a holder, and a portable charger which is used to carry and charge the holder. *HEETs* are a non-combustible product with a tobacco plug that is designed for heating, not smoking. *HEETs* are used in conjunction with a holder into which the *HEETs* are inserted. The holder heats the tobacco plug by means of an electronically controlled heated blade to create a vapour containing nicotine and tobacco flavours and is designed to significantly reduce the amount of harmful and potentially harmful constituents as compared to a traditional cigarette.

IQOS heats tobacco to a low temperature, below 350°C, without combustion, fire, ash, or smoke, which is just enough to release a nicotine-containing vapor without burning the tobacco. Because the tobacco is heated and not burned, the levels of harmful chemicals are significantly reduced compared to cigarette smoke.

Current Tax Framework:

In the Excise Act, 2001, HTPs fall under the broad catch-all category of “Other Tobacco Products.” The Other Tobacco Products category include Roll-Your-Own and Pipe Tobacco, which have very different characteristics to HTPs. While both HTPs and products in the Other Tobacco Products category contain tobacco, Roll-Your-Own and Pipe Tobacco are intended to be consumed through combustion by burning the tobacco to create smoke. The combustion of these products creates the toxic substances associated with the adverse health effects of smoking.

In addition, Roll-Your-Own and Pipe tobacco are sold as loose tobacco in a tub or pouch - usually in 50 gram increments reflecting the FED tax determination, which uses 50 grams or fraction of 50 grams. Taxation based on 50 gram increments suggests that the tax framework is tailored according to the product characteristics. However, HTPs are completely different and much more complex products when compared to Roll-Your-Own and Pipe Tobacco and they are sold in packages of sticks or capsules. Since the tobacco in a 20 stick selling unit of Rothman, Benson & Hedges’ *HEETs* weighs only 6.2 grams, its FED is based on 50 grams which results in consumers paying FED at a rate that is 8 times more than the actual FED rate, and 3 times more compared to a pack of 20 cigarettes. This presents a significant challenge in making HTPs available to legal-aged smokers in Canada and indicates that the current excise category does not leverage the opportunity presented by HTPs to accelerate the end of smoking.

Current Market:

There are already over 5 million adult smokers worldwide who have switched from cigarettes to HTPs with approximately 10,000 smokers switching every day. This trend will continue as awareness of HTPs grows among adult smokers, the science behind the notion of harm reduction compared to cigarettes becomes more widely accepted, and the product offerings expand and improve. However, this shift towards reduced risk products requires a tax framework to reflect the relative risk of HTPs to allow for growth and innovation in this space within Canada.

International Tax Modernization:

To date, 23 governments around the world have already recognized that HTPs are different from other tobacco products and created a unique tax category for HTPs or have announced their intention to do so. The following provides an overview of countries who have adopted or have announced their intention to adopt an HTP category in their respective tax frameworks:

Exhibit 4: Countries with Heated Tobacco Product Categories

Country	Category Reference
Bulgaria	Heated tobacco product
Cyprus	Heated tobacco product
Croatia	Heated tobacco product
Czech Republic	Heated tobacco product (draft legislation)
Denmark	Heated tobacco
Greece	Electrically heated tobacco product
Hungary	Novel tobacco products
Italy	Inhalation tobacco product without combustion
Israel	Tobacco specifically for use in a device for vaping aerosol created by heating the tobacco
Japan	Heated tobacco (effective October 2018)
Kazakhstan	Heated tobacco product
Latvia	Heated tobacco product
Lithuania	Heated tobacco product (effective March 2019)
Montenegro	Heat-not-burn tobacco
Poland	Novel tobacco products
Portugal	Heated tobacco product
Romania	Heated tobacco product
Russia	Heated tobacco product
Serbia	Tobacco that is heated but not combusted
Slovakia	Smokeless tobacco product
Slovenia	Manufactured tobacco intended for heating
South Korea	Inhaling tobacco products using electronic devices
United Kingdom	Tobacco for heating (draft legislation)

Recently, the United Kingdom announced its intention to create its own HTP tax category, which is expected to be effective in early 2019. The new category for HTPs was deemed necessary as HM Treasury found that the creation of a HTP tax category would reflect the market and allow for HTPs to be appropriately taxed:

“Introducing a new category would give certainty to consumers and producers about the duty heated tobacco products are liable for, reduce complexity in the duty system and ensure that products are captured efficiently. Having a clear definition that captures the full range of heated tobacco will also mean that there is less incentive for manufacturers to attempt to reduce their duty liability by producing products which do not clearly fall within an existing category.” – HM Treasury

Recommended Heated Tobacco Products Tax Category:

To reflect the unique nature of HTPs while allowing for Canada to appropriately tax HTPs there needs to be a unique tax category which clearly defines HTPs as manufactured tobacco products that generate nicotine containing aerosol without combustion of tobacco mixture. In addition, the tax rate used for such a category should reflect the product

characteristics as well as the relative risk compared to other tobacco products. This can be done by having a tax rate for HTPs that is lower than combustible tobacco products, and not having a minimum increment for tax determination. Since the common consumable of HTPs is the tobacco mixture, a manageable and transparent method to tax tobacco mixture irrespective of the format of HTPs would be to mirror what many countries have done and determine a specific tax by weight of the tobacco mixture. Tobacco mixture as a tax base would provide level playing field in taxation of various HTPs with different tobacco mixture content.

Conclusion:

Rothman, Benson & Hedges recommends that Canada mirrors the tax framework being adopted by many countries across the globe with a specific tax framework for Heated Tobacco Products (HTPs) that is calculated per weight of tobacco mixture. By doing so, Canada will appropriately tax HTPs and give certainty to manufacturers and consumers. A modernized tax approach to HTPs will allow for the millions of smokers in Canada to have a choice to convert to a smoke-free product such as HTPs - thus driving forward the Government's goal of 5% smoking incidence by 2035.