



**IMPERIAL TOBACCO
CANADA**

2021 Pre-Budget Submission

House of Commons Finance Committee

August 2020

Recommendations

#1: Avoid new tax increases, industry costs and non-urgent regulations.

#2: Launch a Committee study on recouping the billions in lost tax revenue due to the illegal tobacco trade.

#3: Avoid regulatory or tax measures for vaping products that undermine their potential as a reduced risk option for adult smokers.

1. ABOUT ITCAN

Imperial Tobacco Canada Limited (ITCAN) is a wholly-owned subsidiary of British American Tobacco plc (“BAT”) – a leading tobacco company and the world’s largest vaping business by market share. ITCAN has expanded its portfolio of available products in Canada with the introduction of our “Potentially Reduced Risk Products” portfolio, which includes vaping products.¹

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

2. PANDEMIC REALITIES

There are two ongoing impacts of the COVID-19 pandemic for our business that need to be accounted for when planning the 2021 budget.

First, as the pandemic spread, our supply chain for tobacco and vaping products was severely stretched as Canadian jurisdictions and foreign governments imposed closure orders. In effect, from March to June our internal resources were consumed with adapting to this changing situation and ensuring supply continued to flow into Canada. While the major threats of a supply interruption have abated for now, this remains a concern and complying with new regulations that require major operational changes is not possible in the near to medium term.

Second, the consumer impact has been profound and remains so, with record unemployment and households struggling to meet their financial obligations. This is not the time to impose additional costs on the population, such as tax increases, or on the industry, which would get passed on to consumers through higher prices.

This is particularly the case with tobacco as smokers have a thriving illegal market to which they can turn for cheaper products (see next section). Therefore, we support the recommendation of groups like the Canadian Chamber of Commerce² to avoid new tax increases and non-urgent regulations.

Recommendation #1: Avoid new tax increases, industry costs and non-urgent regulations.

¹ We use the term “Potentially Reduced Risk Products” to cover tobacco and nicotine products that, based on the available science, have been shown to be reduced-risk; are likely to be reduced risk; or have the potential to be reduced-risk, in each case if switched exclusively as compared to continuing to smoke cigarettes.

² <http://www.chamber.ca/media/news-releases/200325-leading-biz-organizations-call-on-gov/>

However, recognizing that all sectors are going to have to help governments recover from the fiscal challenges of the pandemic, we continue to support the excise tax model introduced in the 2018 budget that provides for an annual tobacco tax increase based on a model tied to inflation.

3. ILLEGAL TOBACCO: ACT NOW

Illegal tobacco trafficking continues to be a drain on the finances of governments across Canada, a primary source of profit for the criminal groups behind it, and a major threat to public safety. The current contraband tobacco market in Canada results primarily from illegal manufacturing, which involves 50 illegal cigarette factories and approximately 300 smoke shacks located on some First Nations territories. The illegal tobacco is trafficked across Canada and sold outside existing legal, regulatory and tax frameworks by groups which have ties to organized crime.^{3,4}

Illegal tobacco consumes around 20% of the Canadian market, with Governments losing upwards of \$2 billion in tax revenue annually.⁵ Since 2006, **at least \$30 billion** of tobacco tax revenue has been diverted from the Federal and Provincial Governments into the pockets of some of the most notorious organized crime groups in Canada.⁶

In addition, numerous reports from law enforcement agencies, think tanks and the media have drawn clear links between illegal tobacco and other criminal activities, including drug and weapons trafficking, human smuggling, money laundering and even terrorist financing.⁷ The RCMP acknowledges the growth of the industry and has drawn the link between illicit tobacco and other criminal activities.⁸

Those links were laid bare, once again, in a June 11 announcement of a major law enforcement operation in B.C., Ontario and Quebec.⁹ An organized crime group was manufacturing cigarettes on First Nations territory in Ontario and shipping them for sale in B.C. The operation also discovered large shipments of cannabis were being sent weekly from B.C. to Ontario.

The release from the Ontario Provincial Police announcing this operation makes clear that those arrested “are closely associated with members of Traditional Organized Crime and other organized crime groups.” In addition to 11.5 million illegal cigarettes, law enforcement

³ <https://www.opp.ca/index.php?id=115&lng=en&entryid=590a25088f94ac74657b23c6>

⁴ RCMP testimony to the House Public Safety Committee, April 27, 2010.

⁵ Estimate based illegal tobacco market share versus Federal and Provincial Tobacco Tax revenues as detailed in Public Accounts.

⁶ Based on tax losses estimated at \$2 billion a year since 2006.

⁷ See, for example, <https://www.opp.ca/index.php?id=115&lng=en&entryid=590a25088f94ac74657b23c6>, et <https://2009-2017.state.gov/documents/organization/250513.pdf>.

⁸ <http://www.rcmp-grc.gc.ca/ce-da/tobac-tabac/index-eng.htm>

⁹ Details are available here: <http://opp.ca/news/#/viewmediakit/5ee2296c2c725>

agencies seized 1,714 pounds of cannabis; 1.14 kilograms of cocaine; and 1.3 kilograms of fentanyl – **enough to kill 650,000 Canadians**.¹⁰ Police also seized huge amounts of cash and weapons – and among the charges was conspiracy to commit murder. This ought to dispel any remaining myths about the type of people involved in the illegal tobacco trade and shows why action is needed.

Illegal tobacco has its origins in simple supply and demand economics: a) a desire by consumers to save money by willingly purchasing much less expensive illicit products, and b) the potential for criminals to make high profits.¹¹ Excessive taxation drives demand. A carton of legal cigarettes sells for between \$95-140, depending on the Province,¹² with taxes making up around 75% of the average retail price. The RCMP estimates the same number of cigarettes can cost as little as \$12 on the illegal market,¹³ with no taxes paid. The supply side is driven by the illegal factories and smoke shacks and the organized crime groups that traffic contraband tobacco across Canada.

The demand side is expected to be more pronounced as a result of the pandemic and its impact on unemployment and household finances. Cheaper, illegal products will become much more attractive. This will need to be closely monitored in the months to come.

Also, just before the pandemic hit in February, Canada had fully implemented plain and standardized tobacco packaging and products, meaning there is no longer any opportunity to distinguish a legal pack or product from an illegal counterpart. The market impact of this will take months to assess, which is another reason to be cautious and avoid any other shocks.

Meanwhile, Federal leadership and action on illegal tobacco are long overdue. The pandemic provided a brief window into what the world could look like with less illegal tobacco, as many traffickers shut down operations due to inter-provincial roadblocks. This led to a significant increase in legal tobacco sales – upwards of 20% in some regions. This suggests consumers will return to the legal market in large numbers if the supply side of the equation is addressed, and an increase in legal sales at the expense of criminal groups would mean a greater increase in tobacco tax revenue than a tax increase could ever deliver.

That increase in legal sales during the pandemic should also demonstrate that enforcement actions could easily pay for themselves, as has been demonstrated repeatedly in Quebec, which has the most robust anti-illicit tobacco enforcement regime in Canada and has lowered its illegal tobacco rate from over 40% to around 12%. As for public safety, illegal tobacco is one of the most lucrative criminal enterprises in Canada today. For anyone concerned about drugs, money laundering and the proceeds of crime, this is an important place to focus attention.

Recommendation #2: Launch a Committee study on recouping the billions in lost tax revenue due to the illegal tobacco trade.

¹⁰ A lethal dose is generally considered to be 2 mg.

¹¹ The Illicit Trade in Tobacco Products and How to Tackle It, International Tax and Investment Center, 2012.

¹² <https://www.statista.com/statistics/449041/price-of-200-cigarettes-by-region-canada/>

¹³ <http://www.torontosun.com/2016/01/16/the-sleeping-dog-of-contraband-cigarettes>

4. REDUCED HARM PRODUCTS

Harm reduction is a priority for our company. Smoking poses real and serious health risks and the only way to avoid these is not to smoke. However, many adults choose to continue to smoke, so working to develop and commercialize potentially less risky alternatives has been a strategic priority for our company for many years. To that end, we have introduced Potentially Reduced Risk Products into the Canadian market, such as vaping products, which have no tobacco or combustion and produce a vapour that is inhaled.

Vaping products are distinct from tobacco products, as recognized by the Federal Government and many provinces. Their reduced harm potential has also been recognized by Health Canada, which has stated that it is “of the view that while vaping products are harmful, they are less harmful than smoking cigarettes,” and “Smokers who switch completely to vaping products can significantly reduce their exposure to toxic chemicals and carcinogens.”¹⁴

However, an appropriate legislative, regulatory and tax framework is critical if these products are to fulfill their public health potential. To that end, vaping products should remain accessible and affordable to adult smokers to encourage them to switch, which is the goal of health entities like the U.K. College of Physicians,¹⁵ Public Health England,^{16,17} France’s Académie nationale de médecine,¹⁸ and New Zealand’s Ministry of Health.¹⁹

Closer to home, the University of Victoria released a comprehensive study of vaping products in January 2017²⁰ that recommended “Canadian regulations of vaping 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 vaping devices.”²¹

Keeping this in mind, any tax regime for vaping products should be proportionate to risk (knowing that vaping products have been recognized to be as much as 95% less harmful than cigarettes); simple to administer (for example, not tied to nicotine concentration); and applicable only to the consumable – the liquid itself – and not the device or accessories. Attempts to implement anything more complicated could mean the Government spends more than it could collect in the enforcement of a regime that some may circumvent through loopholes or ignore altogether.

¹⁴ <https://www.canada.ca/en/health-canada/news/2018/05/backgrounder-vaping-products.html>

¹⁵ <https://www.rcplondon.ac.uk/projects/outputs/nicotine-without-smoke-tobacco-harm-reduction-0>

¹⁶ <https://www.gov.uk/government/news/e-cigarettes-around-95-less-harmful-than-tobacco-estimates-landmark-review>

¹⁷ <https://www.gov.uk/government/news/phe-publishes-independent-expert-e-cigarettes-evidence-review>

¹⁸ <http://www.academie-medecine.fr/wp-content/uploads/2019/12/Cigarette-e%CC%81lectronique-10-12-19.pdf>

¹⁹ <https://www.health.govt.nz/news-media/news-items/ministry-health-reminder-about-vaping>

²⁰ <https://www.uvic.ca/home/about/campus-news/2017+e-cigarettes-carbc-macdonald-stockwell+media-release>

²¹ Ibid.

A harmonized and coordinated federal-provincial approach is also recommended, especially since, unlike tobacco products, vaping products are produced by a wide range of smaller manufacturers and can be bought online and transported interprovincially.

Finally, Health Canada has previously consulted on things like permitted flavours and nicotine levels in vaping products. The Government needs to tread carefully in this area to avoid driving consumers back to smoking and/or pushing them to the black market.

Recommendation #3: Avoid regulatory or tax measures for vaping products that undermine their potential as a reduced risk option for adult smokers.

5. CONCLUSION

The immediate recommendation for the 2021 budget is to put a pause on new tax increases, industry costs and non-urgent regulations during the pandemic recovery period. Then, the Government has to recognize the billions being lost annually to the illegal tobacco trade and, at a minimum, launch a Committee study of the issue. Continued inaction benefits only the organized crime groups behind the illegal tobacco trade. Longer term, as fiscal realities set in, it will become increasingly untenable for the Government to cut program spending while leaving the billions lost to illegal tobacco untouched.

Finally, vaping products offer smokers a potentially reduced risk option and any regulatory and tax measures should avoid undermining that potential.