IMPERIAL TOBACCO CANADA

2020 Pre-Budget Submission to the Standing Committee on Finance and Economic Affairs

January 24, 2020

Executive Summary

There are two significant issues regarding tobacco and vapour products in Canada at present: the persistent existence of a thriving illegal tobacco trade that deprives the Federal and Provincial Governments of billions in tax revenues annually, including at least $750 million annually in Ontario, and concerns about youth use of vapour products.

The issue of youth vaping is generating remarkable political and media attention and a rash of policy responses, many of which fail to recognize the source of the problem is a) black market products and b) the failure to enforce existing laws. More fundamentally, reactionary policy decisions not based on fact threaten to eliminate vapour products as a reduced harm option for smokers unwilling or unable to quit. Therefore, this submission seeks to clarify the facts around vapour products in Canada with a view to addressing youth use while protecting the products as a viable alternative for adult smokers.

As for illegal tobacco, while arguably a much more significant problem, especially in Ontario, it is getting virtually no policy attention from the Federal Government and promised actions in Ontario have not been implemented. As a result, the criminals behind the illegal trade continue to profit, billions of dollars of tax revenue get diverted to organized crime, and many aspects of tobacco control are rendered virtually meaningless.

Furthermore, the Federal Government is about to make the problem worse as plain and standardized tobacco packaging and products will be largely implemented in Canada by February 2020. This will make it virtually impossible for consumers, retailers and law enforcement officers to tell a legal from an illegal tobacco pack or cigarette and there is a very real risk of a further illegal tobacco market expansion.

As a result, further disruptions to the market, such as tax increases, should be avoided in 2020. Moreover, the Province needs to act on past commitments to address illegal tobacco, particularly those made in the 2018 Fall Economic Statement. The need for Federal leadership is also long overdue.

Recommendation #1: Address issues around youth vaping based on fact with a focus on how youth are accessing these products and imposing harsh penalties on those who are furnishing products to youth.
Recommendation #2: Ensure policy decisions around vapour products, including taxation, do not undermine their potential as a viable reduced risk alternative for adult smokers.
Recommendation #3: Introduce a harmonized excise tax regime applicable on liquids regardless of nicotine concentration with a minimum of 2 mL per closed system cartridge.
Recommendation #4: Maintain tobacco taxes at their current level in 2020 due to significant market disruption associated with implementation of plain and standardized tobacco packaging and products and high illicit tobacco rates.
Recommendation #5: Implement past commitments to fight illegal tobacco.
Recommendation #6: Demand Federal action to address illegal tobacco.

1. About ITCAN

Imperial Tobacco Canada Limited (ITCAN), established in 1908, is a wholly-owned subsidiary of British American Tobacco p.l.c, a leading tobacco company and one of the world's largest vapour products businesses 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 vapour products.

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. ITCAN believes that underage people should not consume tobacco or vapour products and we support constitutional, reasonable and evidence-based regulation, especially measures aimed at keeping tobacco and vapour 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 still being tainted by an illicit trade – and those who sell illegal tobacco abide by a completely different set of rules. Likewise, there are black and grey market operators in the vapour products business who are undermining the effort to offer these products as a reduced harm alternative for adult smokers.

2. Reduced Harm Products: Striking the Right Balance

Harm reduction is a priority for our company. Smoking poses real and serious health risks and the only way to avoid these risks 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 (PRRPs) into the Canadian market, such as vapour products, which have no tobacco or combustion and produce a vapour that is inhaled.

Vapour products are distinct from tobacco products, and this has been recognized by the Federal Government. For example, when the Federal Government introduced legislation on vapour products, the then Health Minister stated "[W]e know that there is some evidence to suggest that the use of vapour products can be used as a harm-reduction tool for people who are current smokers."[1]

That legislation, which is now law, proposed to regulate vapour products "as a separate class of products," as detailed in a statement from Health Canada.[2] When announcing it, Health Canada also stated that it is "of the view that while vaping products are harmful, they are less

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[1] https://www.cbc.ca/news/health/vapour-health-canada-legislation-1.3862589

[2] Ibid.

harmful than smoking cigarettes," and "Smokers who switch completely to vaping products can significantly reduce their exposure to toxic chemicals and carcinogens."[3]

Just this past May 31, the former federal Health Minister stated: "Vaping products deliver nicotine in a much less harmful way than smoking cigarettes. While vaping products are not intended for non-smokers or young people, smokers who switch completely from cigarettes to vaping products significantly reduce their exposure to dozens of powerful toxins and carcinogens found in cigarette smoke."[4]

However, 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.[5]

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.[6]

An update on the PHE report was released in February 2018.[7] 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;

[3] https://www.canada.ca/en/health-canada/news/2018/05/backgrounder-vaping-products.html
[4] https://www.canada.ca/en/health-canada/news/2019/05/message-from-the-minister-of-health-on-world-no-tobacco-day.html
[5] https://www.rcplondon.ac.uk/projects/outputs/nicotine-without-smoke-tobacco-harm-reduction-0
[6] https://www.gov.uk/government/news/e-cigarettes-around-95-less-harmful-than-tobacco-estimates-landmark-review
[7] https://www.gov.uk/government/news/phe-publishes-independent-expert-e-cigarettes-evidence-review

- 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 U.K. continue to decline. Regular use is rare and is almost entirely confined to those who have smoked.

The RCP's equivalent in France, the Académie nationale de médecine, in light of the U.S. cases of acute lung illness related to vaping (see next section), recently issued a public statement to reiterate its strong support of vapour products as a reduced risk alternative to smoking and one that helps smokers quit. It stated: "Il est établi que la vaporette est moins dangereuse que la cigarette : Comme l'a indiqué l'Académie nationale de médecine dès 2015, il est donc préférable pour un fumeur de vapoter. Santé Publique France indique qu'au moins 700 000 fumeurs ont décroché grâce à la cigarette électronique."[8]

The New Zealand Ministry of Health also has a fairly enlightened view, stating "vaping is not risk-free but it is less harmful than smoking."[9] The Ministry has also said "Vaping is a way to quit cigarettes by getting nicotine with fewer of the toxins that come from burning tobacco."[10]

Here in Canada, the University of Victoria released a comprehensive study of vapour products in January 2017.[11] 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."[12]

For consumers to take advantage of reduced harm products, they need to be accessible and affordable. At the same time, we recognize – and share – the concern about youth access to these products. However, addressing that issue requires a fact-based discussion and a more robust enforcement of existing federal and provincial laws.

Setting the Record Straight on Vapour Products

Having a discussion based on facts is the only way to reach an outcome that prevents youth use of vapour products while still protecting them as a reduced harm alternative for adult smokers. With that in mind, please find below clarifications on several matters related to vapour products.

First, on November 8 the U.S. Centers for Disease Control (CDC) reported a "breakthrough" in their investigation of vaping-related illnesses, stating their findings "provide direct evidence of

[8] http://www.academie-medecine.fr/wp-content/uploads/2019/12/Cigarette-e%CC%81lectronique-10-12-19.pdf
[9] https://www.health.govt.nz/news-media/news-items/ministry-health-reminder-about-vaping
[10] https://vapingfacts.health.nz/the-facts-of-vaping/
[11] https://www.uvic.ca/home/about/campus-news/2017+e-cigarettes-carbc-macdonald-stockwell+media-release
[12] Ibid.

vitamin E acetate at the primary site of injury within the lungs."[13] This confirms earlier reports suggesting the U.S. illnesses are linked to this additive which tends to be mixed with THC vapour products obtained on the black market. The CDC issued another update on December 31 and again put the focus on THC vapour products mixed with this additive.[14] Most importantly, it is critical to note that vitamin E acetate is already a prohibited additive for vapour products in Canada.

Second, there is a very real risk of policy decisions being made based on questionable information. For example, on November 21 the *Globe and Mail* and several other media outlets published articles detailing the first case of "popcorn lung" in Canada, a condition tied to inhaling diacetyl. However, what those articles fail to mention is that none of the vapour products sold by law-abiding companies like Imperial Tobacco Canada contain this ingredient and that Health Canada has given direction to the industry to not use it.

As always, we are compliant with this directive, but some others may not be, and these media reports suggest the individual in this case purchased his products online (and may also have mixed them with THC). Regardless, this case demonstrates once again that companies like ours that sell nicotine-based vaping liquids primarily through the convenience store channel can be relied upon to follow the law and any additional guidance from authorities.

Therefore, to sum up on "vaping related illness," the U.S. cases are tied to THC and a banned additive in Canada, and the one case with any published details in Canada is tied to a black market product using an ingredient Health Canada has given direction to not use. That means that products that adhere to regulations and strict quality control standards should not be included in any discussion about vapour products and "related" illness. For example, there is no evidence from Canada, the U.S. or anywhere else in the world that our products are tied to such cases.

Moving on to the issue of youth use, we are once again confident our product is not the cause. According to Statistics Canada, there are 2,114,635 youth aged 15-19 in Canada, which is the equivalent of high school age.[15] It is therefore impossible that it is our product being used in large numbers by youth, as some anti-tobacco lobbyists suggest, as we simply have not sold anywhere near the volume of product in Canada needed to supply the claims that 20% or more of youth have tried vaping. Even if every single Vype device we sold in Canada (approximately 100,000 devices) somehow got into youth hands, that would still only represent less than 5% - nowhere near the levels of youth vaping being suggested.

Moreover, we are confident that our products are not being sold to youth because we sell almost exclusively through the convenience store channel – and convenience stores have a proven track record selling age-restricted products. In Ontario, for example, 19,679 mystery shopping checks were conducted in 2018 by public health units in support of the *Smoke Free*

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[13] https://www.washingtonpost.com/health/2019/11/08/potential-culprit-found-vaping-related-lung-injuries-deaths/?wpisrc=al_news__alert-hse--alert-national&wpmk=1
[14] https://www.cdc.gov/tobacco/basic_information/e-cigarettes/severe-lung-disease.html
[15] https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1710000501

Ontario Act, and convenience stores were found to be 96.2% successful at denying sales to those under 19.[16]

You may also wish to contrast that with vape shops, since some public health groups suggest vapour products should only be sold through that channel. However, Health Canada found that more than 75% of specialty vape shops were selling and promoting products that violate federal law and have reportedly seized 60,000 non-compliant products.[17]

We do not wish to deny youth vaping is preoccupying, but merely to suggest they are not supposed to be accessing our products legally. Therefore, we once again encourage governments to determine what products youth are using and how they are being obtained.

Next, media reports often reference "thousands" of flavours available for vapour products. To be clear, our Vype products in Canada come in a limited amount of tobacco, mint, and some fruit flavours. If there are "thousands" of flavours available in Canada for vapour products, they are not coming from our company. It is also important to recognize that flavours deemed appealing to youth are already banned in Canada, though we recognize that restriction is not being adequately enforced and have called for that to be addressed.

In addition, there is new evidence suggesting flavours are not the critical factor attracting youth. On December 5, the U.S. 2019 National Youth Tobacco Survey data was released. The data shows that 77.7% of youth do not cite flavours as the reason for their use of vapour products. Instead, youth state that curiosity and use by family and friends are far more significant driving factors for trying a vapour product than flavours.[18]

Conversely, there is empirical and anecdotal evidence from adult smokers that flavours are an important factor in making the transition away from cigarettes as they are looking for something other than the taste of burnt nicotine.[19] Therefore, calls to ban flavoured vapour products could have very real consequences as such action may push vapers to the illicit market, which is where the health risks associated with questionable ingredients seem to lie based on recent evidence, or back to smoking, where the health implications are well known.

Lastly, it is worth taking a step back and asking whether Ontario wants to have vapour products available as a potentially reduced harm alternative for smokers. Therefore, we encourage you to study the approach of Public Health England, which has embraced vapour products as a reduced harm alternative for smokers without the problem of youth usage – and without resorting to taxation, flavour bans or other excessive regulations that make these products less appealing or less accessible as an alternative to smoking. In fact, the director of the U.K. Centre

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[16] https://convenienceindustry.ca/vaping/
[17] https://www.theglobeandmail.com/canada/article-vaping-advertising-marketing-investigation/
[18] https://www.cdc.gov/mmwr/volumes/68/ss/ss6812a1.htm?fbclid=IwAR1EdnvCtErQbHtum0RhHKwuJe_4h9TGzBfp03ivI9gq8Php973nsuqFVEA
[19] See http://www.jeffstier.org/18998/q-a-defending-electronic-cigarettes-to-the-white, Farsalinos et al. International Journal of Environmental Research and Public Health 10, no. 12 (2013), and Tackett, A. P., et al. (2015). Addiction 110(5).

for Alcohol and Tobacco Studies has called the knee-jerk response to vaping concerns in the U.S., which some provinces have now emulated, "complete madness."[20]

Virtually anyone who is not an anti-tobacco industry advocate recognizes the reduced harm potential of vapour products, yet we now have governments working with those same advocates to impose regulations that threaten to severely restrict, if not eliminate, this option for smokers, and that may have real public health consequences.

The media, anti-tobacco industry lobbyists and some politicians have fuelled a hysteria over vapour products that has led to an erosion of smokers' confidence in these products in recent months, resulting in a decline in vapour product sales in Canada and a resurgence in the sales of combustible cigarettes. If all smokers switched to vapour products, smoking-related illness could potentially be significantly reduced in a generation. Instead, government policy decisions are on the verge of eliminating vapour products as a viable reduced harm option for smokers.

Preventing Youth Access

We believe the focus to deal with youth vaping should concentrate on the issue of access, coupled with enforcement. It is important to remember that it is already illegal for youth to purchase a vapour product. Therefore, if that is happening, the system has broken down somewhere along the line and we need to determine how youth are accessing these products illegally.

In the meantime, we recommend the Ontario Government address underage youth vaping head-on by enacting or enforcing the following measures:

- Strong enforcement measures to ensure retailers and third parties obey the law and do not furnish vapour products to youth.
- Stiff penalties for any person caught furnishing vapour products to youth.
- Mandatory training programs for all vapour product retailers.
- A requirement that ID must be provided at the time of delivery of a vapour product ordered online.
- A requirement that mandates online vendors to implement a robust third-party age verification process before accepting any online orders for vapour products.
- Verification and audit requirements for delivery and on-line age verification processes.
- Prohibit online vendors from accepting large multiple orders of vapour products that exceed an amount reasonably required for personal use or the use of adult family members.

ITCAN itself currently complies voluntarily with the last four points above with respect to its online consumer purchase system. We believe that all participants in the online vaping market in Canada should be required to do the same. ITCAN has also initiated a Youth Vaping Prevention Program, which includes working with our vapour and tobacco product retail

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[20] https://www.cnbc.com/2019/09/28/the-uk-is-embracing-e-cigarettes-as-an-anti-smoking-tool-as-the-us-cracks-down-on-vaping.html

partners to deliver training in relation to ensuring no sales are made to youth in their stores. The Government of Ontario should impose a requirement that this form of training be undergone by all vapour and tobacco product retailers.

Taxation of Vapour Products

Given the role that vapour products can play in a tobacco harm reduction strategy and commensurate to the proportional risk continuum, a balanced approach to taxation beyond the current level of HST should be considered so that they remain an accessible and affordable alternative for adult smokers seeking to transition away from combustible cigarettes. Taxing these products at the same level as tobacco (as some advocate) would drastically undermine the harm reduction potential of vapour products for smokers.

Moreover, a high tax policy risks driving sales to the illegal market, as is already the case with tobacco products. Keep in mind the illicit market was the sole channel for nicotine vapour products before its legalization in May 2018 and such a market could easily be re-established in the face of high taxation and/or regulation. An increased illicit market in vapour products would also undermine suggestions that taxation is an effective measure to address youth use and any regulatory framework adopted for the category. Ultimately, illicit traders have shown no reluctance to sell their products to minors in the past.

Furthermore, most of the vapour product taxation models implemented around the world have been abject failures. For example, Italy introduced tax that was expected to generate €117M, but instead delivered €3M. Portugal's introduction of a vapour products tax led to an immediate 50% drop in legal sales, leading it to cut its tax by 50% with an expected increase in legal sales of 250% back in 2014.[21] The experience has been similar in the handful of U.S. States that have introduced a tax. For example, Louisiana's revenue collection came in 30% below projections and South Carolina was 41% below.[22] Worse still, these revenue schemes have often been accompanied by unexpected administrative burdens and high enforcement costs.

The key point is that any tax regime for vapour products should be proportionate to risk, (recognizing that vapour 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 nicotine consumable – the liquid itself – and not the device or accessories. Any attempt to implement anything more complicated could mean that the Province spends more than it could collect in the enforcement of a regime that some operators may circumvent through loopholes or ignore altogether.

Finally, a harmonized and coordinated federal-provincial approach is recommended, especially since, unlike tobacco products, vapour products can be bought online and transported interprovincially. Thus, if Ontario levies a vapour product tax and other provinces do not, vapers may likely just buy from elsewhere.

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[21] Euromonitor International Tobacco Market eports on Italy and Portugal; see Euromonitor.com.
[22] Based on official State data, 2016.

Given all the above, ITCAN recommends the following approach to the taxation of vapour products:

- Introduce a federal/provincial harmonized tax on all liquids designed for vaping proportional to the risk continuum, including:
    - A uniform level of taxation regardless of the nicotine concentration of the liquid (including liquids with no nicotine);
    - Apply the tax linearly on a per mL basis with a minimum tax of 2 mL applied per closed system cartridge or pod to ensure a minimum tax is charged. (A closed system cartridge or pod is defined as a single-use pre-filled disposable cartridge or pod.)

Recommendation #1: Address issues around youth vaping based on fact with a focus on how youth are accessing these products and imposing harsh penalties on those who are furnishing products to youth.
Recommendation #2: Ensure policy decisions around vapour products, including taxation, do not undermine their potential as a viable reduced risk alternative for adult smokers.
Recommendation #3: Introduce a harmonized excise tax regime applicable on liquids regardless of nicotine concentration with a minimum of 2 mL per closed system cartridge.

3. ILLEGAL TOBACCO: TIME FOR ACTION

Ontario's Worsening Illegal Tobacco Problem

For over a decade now, Ontario has been the epicentre of Canada's illegal tobacco trade, and the Government's own estimates suggest the tax losses are $750 million annually.[23] According to data from the Ontario Convenience Stores Association, the illegal tobacco rate in the Province spiked by 67% over three years under the previous Government, growing from 22.3% in 2014, to 24.6% in 2015, 32.8% in 2016 and 37.2% in 2017.[24]

As the Ford Government correctly noted in its 2018 Fall Economic Statement, illegal tobacco "undermines Ontario's tax system, creates an unfair business advantage, and compromises the health and public safety of Ontario families."[25] That 2018 Statement then made several commitments to address illegal tobacco, including a public awareness campaign that informs the public about how to identify illegal tobacco and the consequences and risks of participating in the illegal market; expanding the Contraband Tobacco Enforcement Team within the Ontario Provincial Police; and a tobacco enforcement grants program to create incentives for local and regional police to take on more investigations into illegal tobacco.

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[23] Figure cited in the November 15 Fall Economic Statement.
[24] http://ontariocstores.ca/2017contrabandstudy/
[25] https://www.fin.gov.on.ca/fallstatement/2018/chapter-1c.html#s-28

These measures are similar to those in place in Quebec, which is the gold standard in terms of illegal tobacco enforcement in Canada. Quebec has reduced its illegal tobacco rate from over 40%[26] to around 12%.[27] This has led to significant increases in tobacco tax revenue.[28] According to Government estimates, Quebec's annual revenue losses due to illegal tobacco dropped from over $305 million annually to roughly $125 million annually – or almost 60%.[29] Using the Ontario estimates of annual tax losses of $750 million, a 60% drop in the illegal tobacco market share would translate into $450 million annually in recouped revenue.

Unfortunately, the measures promised in 2018 have not been implemented. Worse still, the Federal Government is poised to make the problem significantly worse with the implementation of plain and standardized tobacco packaging (see next section). Ergo, the lack of action since the commitments were made has put Ontario in a very precarious position. A whole new set of illegal tobacco enforcement challenges is about to hit, and now it seems neither Ontario nor the Federal Government have a plan to deal with it.

To put this in context, 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 175 groups which have ties to organized crime.[30]

Since 2006, illegal tobacco has consumed 20-33% of the Canadian market, depending on the year. Federal and Provincial Governments lose upwards of $2 billion in tax revenue annually as a result.[31] In the same period, therefore, at least $28 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.[32] 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.[33] The RCMP acknowledges the growth of the industry and has drawn the link between illicit tobacco and other criminal activities.[34]

The illegal tobacco trade has its origins in simple supply and demand economics. The primary drivers of the illegal trade are: 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.[35]

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[26] https://www.publicsafety.gc.ca/cnt/rsrcs/pblctns/archive-stts-cntrbnd-tbcc/index-en.aspx

[27] 2018-19 Quebec Budget, Additional Information, Section B, 2.2, Plan to ensure tax fairness, page B.32.

[28] See the 2014-15 Quebec Budget for details: http://www.budget.finances.gouv.qc.ca/budget/2014-2015a/en/documents/BudgetPlan.pdf

[29] See the 2014-15 Quebec Budget.

[30] RCMP testimony to the House Public Safety and National Security Committee, April 27, 2010.

[31] Estimate based illegal tobacco market share versus estimated Federal and Provincial Tobacco Tax revenues as detailed in the Public Accounts.

[32] Based on tax losses estimated at $2 billion a year since 2006.

[33] 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.

[34] http://www.rcmp-grc.gc.ca/ce-da/tobac-tabac/index-eng.htm

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

Excessive taxation drives demand. Following repeated tax increases by the previous government, a carton of legal cigarettes now sells for around $110 in Ontario,[36] with taxes making up approximately 61% of the average retail price. The RCMP estimates the same number of cigarettes can cost as little as $12 on the illegal market,[37] 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. Given the size of the illegal industry in Canada, without sustained enforcement the supply is virtually limitless – and things are about to get much more complicated.

Canada's Looming Growth of Illegal Tobacco

The implementation of plain and standardized packaging of tobacco products, and the standardization of cigarettes themselves, will make the situation worse as it will make it virtually impossible for consumers, retailers and law enforcement officers to tell a legal from an illegal product. As such, Canada's existing contraband tobacco problem could be supplemented with an influx of counterfeit in legal retail channels. This federal policy will be largely implemented at retail by February 2020.

Further complicating matters, the Federal Government's tobacco excise stamping system has been compromised, with legitimate stamps routinely appearing on illicit product packaging. This issue takes on far more importance in a plain and standardized environment because Health Canada claims the excise stamp will give consumers assurance that the product is legitimate when, in fact, it no longer provides any such guarantee.

In recent months we have spoken with most provinces, and not a single one knows how they will be able to maintain the integrity of their tobacco tax laws in this environment. Then, during a teleconference with the Canada Revenue Agency and provincial Finance departments on February 7, 2019, the Revenue officials were asked what plan has been put in place to deal with this potential enhanced illegal tobacco threat. The response was concerning, with the officials stating, "we don't really have a plan," though that is consistent with recent experience as the Federal Government has barely mentioned illegal tobacco enforcement since 2015.

The time for Federal leadership and action on illegal tobacco is long passed due. Of the roughly $28 billion that has been lost since 2006, around 60% – or $16.8 billion – would have gone to the Provinces – and the bulk of that to Ontario. Therefore, the provinces should be demanding action, with Ontario front and centre.

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[36] https://nsra-adnf.ca/wp-content/uploads/2018/04/180401_map_and_table.pdf
[37] http://www.torontosun.com/2016/01/16/the-sleeping-dog-of-contraband-cigarettes

Market Disruption Looms

Illicit tobacco alone is a significant source of market disruption and a huge competitive challenge for the legal tobacco industry. Adding plain and standardized packaging on top of that in 2020 is another destabilizing force that could further disrupt the industry and the market. Layered on top of that is the fact that the three major legal tobacco companies in Canada are now under court-approved creditor protection. There is over $650 billion in government litigations against the main legal tobacco companies – or one-third the annual GDP of Canada.

For years now, we have been warning that Canada faces a choice between having a legal, regulated and taxed tobacco industry, or an illegal, untaxed, unregulated free-for-all. That choice has never been more apparent. Therefore, given all the above, we recommend the following:

Recommendation #4: Maintain tobacco taxes at their current level in 2020 due to significant market disruption associated with implementation of plain and standardized tobacco packaging and products and high illicit tobacco rates.
Recommendation #5: Implement past commitments to fight illegal tobacco.
Recommendation #6: Demand Federal action to address illegal tobacco.

Note that these recommendations are very similar to those made by the Ontario Chamber of Commerce in a recent report, including a tax freeze until further efforts to address the illegal market are implemented and conducting a feasibility study that examines the Quebec enforcement model with a view to developing a made-in-Ontario solution.[38]

4. Conclusion

Enforcing existing laws and regulations is key to addressing both youth vaping and illegal tobacco. With the former, no youth should be accessing vapour products and the Province needs to figure out how that is happening. In the meantime, we have made a number of recommendations around access and believe anyone caught furnishing a vapour product to youth should face strict penalties.

The possible public health benefits of getting adult smokers to switch to potentially reduced risk products have been recognized by Health Canada and a host of medical and scientific bodies in Canada and around the world. Governments must not lose sight of that when considering how to address the issue of youth vaping, and a delicate regulatory balance must be struck to attain this. Hasty policy responses to this issue, as are being recommended by anti-tobacco industry lobbyists, are likely to do more harm than good, driving vapers to the illegal market or back to smoking.

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[38] https://occ.ca/wp-content/uploads/Guiding-Policy-Principles-for-Tobacco-and-Vaping-Products.pdf

Finally, the illegal tobacco trade is a persistent drain on Ontario's revenues, with that money instead diverted to organized crime groups to fund other criminal activities. Illegal tobacco is, arguably, the most lucrative criminal pursuit in Canada today and it is time for action. The problem could potentially be eliminated if the Federal Government enforced existing laws. As Ontario is losing more tax revenue than anyone due to this inaction, it should make its voice heard.

In the meantime, the Province needs to avoid further fuelling demand for illegal products by raising taxes, while at the same time implementing the enforcement measures announced in the 2018 Fall Economic Statement.