IMPERIAL TOBACCO
CANADA

2022 Pre-Budget Submission to the Ontario Finance Committee

January 24, 2022

Executive Summary

Vaping products offer smokers a reduced harm alternative, as has been recognized by esteemed medical and scientific bodies around the world.[1] However, the public health potential of these products is tied to whether they remain an affordable and accessible alternative for smokers, and both variables are threatened.

On affordability, four provinces have introduced a vaping product tax and the Federal Government is planning its own tax in 2022. If Ontario is considering a tax – which we do not oppose if done correctly – it should engage with Ottawa to ensure harmonization. The combined rate cannot undermine the fiscal advantage of vaping products and must remain aligned with the overall tobacco harm reduction strategy and nicotine risk continuum.

With accessibility, Health Canada has posted a draft regulation to ban almost all vaping product flavours, despite adult vapers showing a clear preference for some of the flavours targeted. Health Canada acknowledges this may lead vapers back to smoking, which is a counterintuitive public health outcome. There is also evidence such bans create an illicit market. Since Ontario has already studied this issue and brought in its own regime that protects adult consumer choice, the Province should demand its approach be respected.

Recommendation #1: Work with the Federal Government to ensure vaping products maintain their relative affordability and tax advantage over tobacco products with the tax level proportionate to their relative risk on the nicotine risk continuum, and pursue a harmonized vaping product tax and stamping regime with the Federal Government.
Recommendation #2: Intervene with the Federal Government to ensure Ontario's regulatory approach to flavoured vaping products is respected.

As for tobacco products, Ontario remains the epicentre of Canada's illegal tobacco trade, with contraband consuming around 35% of the market. Ontario has lost billions in tax revenue over the past 15 years – money that has been diverted to the organized crime groups involved in illegal tobacco. The Province launched a consultation on the issue in its 2019 Fall Economic Statement, but the results have yet to be released. That needs to happen and the path forward should recognize there are four pillars to addressing illegal tobacco: fiscal prudence; modernize the *Tobacco Tax Act* to facilitate and augment enforcement; increase investment in dedicated tobacco trafficking enforcement; and demand action from the Federal Government.

Recommendation #3: Release the report on the "unregulated" tobacco consultation.
Recommendation #4: Maintain fiscal prudence.
Recommendation #5: Modernize the *Tobacco Tax Act* to facilitate enforcement.
Recommendation #6: Significantly increase investments to curb illegal tobacco trafficking.
Recommendation #7: Demand Federal action to address the illegal tobacco in cooperation with the provinces.

---

[1] See notes 4-8.

1. About ITCAN

Imperial Tobacco Canada Limited (ITCAN), established in 1908, 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 "Reduced Risk Products" portfolio, which includes vaping products.[2]

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 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. At the same time, we are committed to contributing to tobacco harm reduction and ensuring consumers are provided with less risky tobacco and nicotine choices.

2. Reduced Harm Products

Smoking poses real and serious health risks and the only way to avoid these is not to smoke. However, many adults still do, so developing less risky alternatives has been a strategic priority for our company for many years. As such, we have introduced Reduced Risk Products, 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 is also recognized by Health Canada, which has stated "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."[3]

Getting smokers who would otherwise continue to smoke to switch completely to reduced risk alternatives is the top priority of our commitment to build "A Better Tomorrow," the strategy guiding our business for the next decade. Given the known health impact of smoking, reducing that impact is our most important ESG responsibility and the greatest societal contribution we can make. If every smoker were to switch to vaping, smoking related illness could potentially be eliminated in a generation, which would be an enormous public health achievement.

---

[2] We use the term "Reduced Risk Products" (or RRPs) to cover tobacco and nicotine products that are reduced risk compared to cigarettes based on the weight of evidence and assuming a complete switch from smoking. These products are not risk free and are addictive.

[3] https://www.canada.ca/en/health-canada/news/2018/05/backgrounder-vaping-products.html

However, an appropriate legislative, regulatory and tax framework is critical if these reduced risk 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,[4] Public Health England,[5,6] France's Académie nationale de médecine,[7] and New Zealand's Ministry of Health.[8]

Unfortunately, both affordability and accessibility can be threatened by ill-advised public policy.

Affordability

Four provinces have imposed a vaping product tax. Thus far, all these taxes have allowed vaping products to remain more affordable than tobacco products, which is key to incentivizing smokers to switch. Therefore, on their own, these taxes are not overly problematic.

However, that affordability advantage could be threatened by the Federal Government, which announced in its 2021 budget a plan to impose its own tax on vaping liquids. While the federal Department of Finance is still developing its proposed tax, the initial model floated for consultation could severely distort the market and greatly undermine affordability, which would be counter to the public health goal of getting smokers to switch to vaping. More importantly, any vaping tax should be proportionate to the comparative risk of vaping products to combustible cigarettes, and vaping products are generally considered to be 95% less harmful than smoking.[9]

Therefore, if Ontario is considering a vaping product tax, we encourage the Province to engage with the Federal Government to ensure vaping products maintain a fiscal advantage over tobacco products proportionate to their relative risk, and to harmonize its vaping tax with the Federal Government. To that end, we appreciate the Government's public statements suggesting harmonization is the Province's preferred approach.[10]

This is consistent with the recommendations put forward by the CD Howe Institute in its analysis of vaping products. On taxation, the Institute stated "A coherent and coordinated policy involving both levels of government would be preferable to a decentralized free-for-all in an area of joint jurisdiction."[11] A fragmented approach is the primary risk in undermining the affordability advantage of vaping products over tobacco products in that it could lead to cascading taxation, as with tobacco. Layered taxation could also distort the tax rate so that it is no longer proportionate to risk.

---

[4] https://www.rcplondon.ac.uk/projects/outputs/nicotine-without-smoke-tobacco-harm-reduction-0
[5] https://www.gov.uk/government/news/e-cigarettes-around-95-less-harmful-than-tobacco-estimates-landmark-review
[6] https://www.gov.uk/government/news/phe-publishes-independent-expert-e-cigarettes-evidence-review
[7] http://www.academie-medecine.fr/wp-content/uploads/2019/12/Cigarette-e%CC%81lectronique-10-12-19.pdf
[8] https://www.health.govt.nz/news-media/news-items/ministry-health-reminder-about-vaping
[9] McNeill, A., Brose, L.S., Calder, R., Bauld, L. and Robson, D. (2018). Evidence review of e-cigarettes and heated tobacco products 2018. A report commissioned by Public Health England. London: Public Health England.
[10] https://torontosun.com/opinion/columnists/warren-more-provinces-take-a-stand-against-vaping
[11] https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/Commmentary_600_0.pdf

Moreover, harmonization is in place for cannabis products, so it is not unprecedented. In that case, harmonization was proposed as a means to ensure the competitiveness of the legal market versus the illegal market. While that dynamic also applies to vaping products (see next section), harmonization is equally important in this case to ensure relative affordability. A harmonized approach would also simplify things like stamping requirements for vaping products.

Recommendation #1: Work with the Federal Government to ensure vaping products maintain their relative affordability and tax advantage over tobacco products with the tax level proportionate to their relative risk on the nicotine risk continuum, and pursue a harmonized vaping product tax and stamping regime with the Federal Government.

Accessibility and Federal Flavour Regulations

On June 18, 2021 Health Canada published draft regulations to prohibit flavours other than tobacco, mint and menthol for vaping products. There are several problems with this, most notably that Health Canada's own analysis suggests this prohibition will drive some vapers back to smoking and may prevent existing smokers from switching. That is a perverse public health outcome, but not surprising when the regulations note the most popular flavours for adult vapers are fruits, which they intend to ban.[12]

This risk was confirmed in a recent study by the International Tobacco Control Policy Evaluation Project at the University of Waterloo, which examined whether vapers from Canada, the US and England who only use non-tobacco flavoured vaping products would support a ban on flavours and how they would respond to such. The researchers surveyed vapers and found 82% opposed a flavour ban. Vapers were then asked what they would do if their preferred flavours were banned, with 57% saying they would continue vaping. Of those, half would opt for an available legal flavour and the other half would find a way to get their preferred flavour, presumably from the illegal market. Meanwhile, 20% said they would stop vaping and smoke instead and 13% said they did not know what they would do.[13]

This is not hypothetical, as real-world evidence is emerging on the impact of flavour restrictions. For example, since Nova Scotia banned flavoured vaping products, cigarette sales increased by 25%.[14] PEI also banned all flavours and media reports suggest some vape shops continue to sell flavoured products in contravention of the ban,[15] showing consumer demand remains. This is also happening in Nova Scotia.[16] Other consumers are resorting to the online market to get their preferred flavours.[17] <u>In short, flavour restrictions risk creating an illicit market for vaping products that could match that for tobacco</u> (see next section).

---

[12] https://www.gazette.gc.ca/rp-pr/p1/2021/2021-06-19/html/reg2-eng.html
[13] The study is available here: https://uwaterloo.ca/news/media/frequent-vapers-non-tobacco-flavoured-e-cigarettes-report
[14] According to a report from the Vaping Industry Trade Association.
[15] See, for example, https://www.cbc.ca/news/canada/prince-edward-island/pei-stratford-vaping-store-fined-1.6129561 or https://www.saltwire.com/atlantic-canada/news/pei-retailer-vapour-trail-charged-with-selling-flavoured-tobacco-products-100666191/
[16] https://novascotia.ca/news/release/?id=20211014010
[17] https://vitaofcanada.com/wp-content/uploads/2019/11/VITA_Flavour_Submission_BM_Final.pdf

Health Canada's proposal also has a significant economic cost as the draft regulations estimate the total cost on thousands of impacted small businesses across Canada at $480.4 million.[18] Again, real world evidence already exists; since Nova Scotia banned flavours, 73% of vape shops in that Province have closed.[19]

By almost any measure, the proposed federal flavour restrictions are misguided: they eliminate adult consumer choice for a recognized harm reduction product; they could drive people back to smoking; and they are economically unviable. Moreover, Ontario already studied this issue when it introduced its vaping product legislation and came up with its own regulatory approach that protects adult consumer choice and will aid the tens of thousands of vapers in the Province who are looking for an alternative to smoking. Unfortunately, Health Canada could undermine Ontario's balanced approach.

Recommendation #2: Intervene with the Federal Government to ensure Ontario's regulatory approach to flavoured vaping products is respected.

If affordability and accessibility are protected, then Ontario should see the public health benefits of smokers switching to vaping. However, if taxes are too high and/or the legal products cease being appealing, vapers could go back to smoking or shift to the illicit market – and there is already evidence of that from places like Nova Scotia and PEI.[20]

3. Combatting Illegal Tobacco: The Four Pillars

For over a decade, Ontario has been the epicentre of Canada's illegal tobacco trade, with tax losses of $750 million annually.[21] 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 in Ontario and Quebec. The illegal tobacco is trafficked across Canada and sold outside existing legal, regulatory and tax frameworks by groups which have ties to organized crime.[22,23]

The illegal tobacco rate spiked by 67% under the previous Government, from 22.3% in 2014 to 37.2% in 2017.[24] We estimate it remains around 35-40%, meaning sustained annual losses of $750 million or more – and at least $12 billion since 2006 – with that money diverted to some of Canada's most notorious organized crime groups and fuelling other criminal activity.

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

[18] Ibid.
[19] https://vitaofcanada.com/wp-content/uploads/2019/11/VITA_Flavour_Submission_BM_Final.pdf
[20] https://vitaofcanada.com/wp-content/uploads/2019/11/VITA_Flavour_Submission_BM_Final.pdf
[21] Figure cited in the November 15 Fall Economic Statement.
[22] https://www.opp.ca/index.php?id=115&lng=en&entryid=590a25088f94ac74657b23c6
[23] RCMP testimony to the House Public Safety and National Security Committee, April 27, 2010.
[24] http://ontariocstores.ca/2017contrabandstudy/

trafficking, human smuggling, money laundering and even terrorist financing.[25] The RCMP acknowledges the growth of the industry and has drawn the link between illicit tobacco and other criminal activities.[26]

As the Government has correctly noted, illegal tobacco "undermines Ontario's tax system, creates an unfair business advantage, and compromises the health and public safety of Ontario families."[27] In seeming recognition of this, the Government has announced some mitigation measures and launched a consultation on illegal tobacco in its 2019 Fall Economic Statement, which it now calls "unregulated" tobacco. However, the latter has yet to report and its findings need to be released publicly so all stakeholders can review the Government's findings.

Recommendation #3: Release the report on the "unregulated" tobacco consultation.

Ideally, that report will include recommendations to address illegal tobacco built around the four pillars approach to combatting this problem.

Four-Pillar Approach for Reducing Illegal Tobacco

We recommend action in four areas to contain and then reduce illegal tobacco. On their own, each measure may offer limited benefit, but implementing all four pillars is how Ontario can make real progress in reducing its illegal tobacco problem.

The first pillar is fiscal prudence, and that requires recognizing 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.[28]

Excessive taxation drives demand. A carton of legal cigarettes now sells for around $115 in Ontario, with taxes making up approximately 65% of the average retail price. The RCMP estimates the same number of cigarettes can cost as little as $12 on the illegal market,[29] 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.

Recent Ontario history provides a case study on this dynamic. Under the previous Government, illegal tobacco rates increased by 67% over a three-year period, from 22.3% in 2014 to 37.2% in 2017.[30] This came at the same time taxes were raised by 33%. While the current Government has adopted a fiscally prudent policy with tobacco taxation, the market is seemingly still impacted by these repeated increases, as the illegal tobacco rate remains stubbornly high (but has at least apparently stopped growing). Regardless, fiscal prudence remains imperative, especially after a tax shock was imposed federally in 2021.

---

[25] 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.
[26] http://www.rcmp-grc.gc.ca/ce-da/tobac-tabac/index-eng.htm
[27] https://www.fin.gov.on.ca/fallstatement/2018/chapter-1c.html#s-28
[28] The Illicit Trade in Tobacco Products and How to Tackle It, International Tax and Investment Center, 2012.
[29] http://www.torontosun.com/2016/01/16/the-sleeping-dog-of-contraband-cigarettes
[30] http://ontariocstores.ca/2017contrabandstudy/

That said, our company is not opposed to tax increases, provided they are moderate and predictable. We would support the Province adopting a model of scheduled, annual increases based on a formula tied to inflation. However, new enforcement measures must be put in place and show results before that can be considered.

Recommendation #4: Maintain fiscal prudence.

The second pillar is to modernize the *Tobacco Tax Act* to facilitate and augment enforcement. Options include empowering all police officers to enforce the Act by making amendments to enable them fully as Ministry of Finance authorized. Another key amendment is to "Section 29 – prohibition re unmarked tobacco products," Subsection (4) "Seizure of unmarked tobacco products in plain view", by removing the "in plain view" provision in the *Act*.

Without this, Ontario peace officers are very limited in their enforcement options. For example, an officer who pulls over a van that wreaks of tobacco is not able to ask to detain the vehicle and its driver or to seek a warrant to see the contents in the back unless the tobacco is in plain sight. Likewise, an officer who receives a tip that a shipment of illegal tobacco is being transported into a community is unable to act without Ministry of Finance officers present.

Recommendation #5: Modernize the *Tobacco Tax Act* to facilitate enforcement.

Closely linked the above, the third pillar is to increase investments in illegal tobacco enforcement. Quebec spends at least $20 million per year on enforcement, and that has delivered, at minimum, a 10:1 return ($180 million in increased tobacco tax revenue, plus indirect returns) as the Province's illegal tobacco rate has dropped from over 40% to under 15%. Conversely, it is estimated Ontario spends $1-2 million annually on enforcement and the illegal tobacco rate has been stuck in the 35-40% range for several years now. Any additional funds put into illegal tobacco enforcement will be recouped through increased revenue.

Recommendation #6: Significantly increase investments to curb illegal tobacco trafficking.

The fourth and final pillar is Federal engagement. The current Federal Government has done nothing to address illegal tobacco – not mentioning it since taking office. Worse still, the Federal Government has introduced measures to give the illegal operators a greater market advantage, such as plain packaging (making it impossible to distinguish a legal from an illegal pack), tax increases, and proposed legislative changes to remove mandatory minimum penalties for repeat contraband offenders. Addressing the source of illegal tobacco requires Federal engagement and leadership. Therefore, Ontario needs to demand the Federal Government come to the table with solutions and work with provinces to implement those.

Recommendation #7: Demand Federal action to address the illegal tobacco in cooperation with the provinces.

5. Conclusion

The tobacco industry is changing as more smokers switch to vaping and other reduced harm products. The two key variables that will allow these products to achieve their public health potential are affordability and accessibility. Those variables need to be assessed against tobacco products and the risk is that tax and regulatory measures could severely undermine both. That would be a disservice to public health and the effort to encourage smokers to switch to a less harmful alternative.

With affordability, if Ontario wishes to implement a vaping product tax, it should be harmonized with the Federal Government and reflective of where vaping products sit on the nicotine risk continuum. With accessibility, the Province should intervene with Health Canada to ensure its balanced approach to vaping product regulation, which allows for adult consumer choice on flavours, is respected.

As for tobacco, contraband remains a drain on the Province's finances and a threat to public safety, as the Government itself has recognized. There are direct links between guns, gangs, drugs and illegal tobacco, so anyone concerned about those issues needs to pay attention. The Province launched a consultation on this issue in fall 2019. That should be concluded expeditiously and a report and recommendations released publicly to begin work towards long-term solutions to this persistent problem.

ITCAN continues to believe the four-pillar approach to fighting illegal tobacco will work, and therefore recommends ongoing fiscal prudence; modernizing the legislative framework to facilitate illegal tobacco enforcement; increased investment in enforcement; and demanding the Federal Government do its share to fight illegal tobacco.