Recommendations:

1. That the government modernize the *Excise Act, 2001* to accurately capture the variety of tobacco and vapour products currently on the market.

2. That the government eliminate the 50-gram increment Federal Excise Tax (FET) rate calculation for smokeless tobacco products and tax these products based on their actual weight, per gram.

3. That the government tax non-combustible tobacco products at lower rates than combustible tobacco products.

16720 Trans-Canada Highway, Suite 209, Kirkland, QC H9H 5M3
T: 514 697-5577 | 1 800 361-6041
www.nstco.ca

Unregulated Sales of Smokeless Tobacco Products

Significant tax burdens and flavoured product restrictions have contributed to a robust unregulated smokeless tobacco resale market. Consumers purchase products from the illicit market primarily because of lower prices. The price disparity between smokeless tobacco products sold in legal, regulated channels and those sold in unregulated channels is more significant than corresponding price disparities found in other tobacco categories. The main reason for this is the high price of smokeless tobacco products in Canada due in part to the current FET rate. The rate is inappropriate because smokeless tobacco products are subject to a tax rate calculation that is designed to address specific issues around an unrelated product, roll-your-own tobacco for smoking.

Beginning in 2008 the federal government made two tobacco tax policy changes to the "manufactured tobacco" category intended to address concerns around roll-your-own tobacco for smoking. First, products were to be taxed at a minimum of 50 grams, and in 50-gram increments. This change was implemented in order to eliminate the large number of smaller package sizes in the roll-your-own tobacco segment ahead of new federal tax stamping requirements. Second, the "manufactured tobacco" category was to be subject to larger tax rate increases than the "cigarette" category to ensure that roll-your-own tobacco for smoking and cigarettes were taxed equally. Neither of these changes was designed to address issues concerning smokeless tobacco products, which are manufactured and consumed differently.

There are vast quantities of illegally-imported, untaxed smokeless tobacco products being sold to non-Indigenous persons on reserves throughout Canada. These products retail for at least $10 less than a 34-gram can of smokeless tobacco sold off-reserve in the convenience-gas channel.[1] Beyond the widespread availability of untaxed smokeless tobacco products on reserves, there is a growing secondary resale market through online marketplaces. In 2019 NSTC established a tracking system for suspected unlawful resale of smokeless tobacco products through these marketplaces and is regularly reporting findings to provincial government officials for investigation.

Smokeless tobacco sold on-reserve and sold by third-party resellers is usually illegally-imported, untaxed U.S. product. Products which retail in the U.S. for between $4 and $10 USD are re-sold in Canada for two to three times that amount which is still considerably cheaper than legal, federally stamped and taxed Canadian products. The impact of COVID-19 travel restrictions on the sale of unregulated smokeless tobacco products has been considerable and has provided a real-time, in-market test of what happens when lower-priced commodities are no longer available. With the closure of the Canada-U.S. border and the restriction of non-resident access to many reserves, the sale of smokeless tobacco products in the legal market has rebounded in many regions. With limited or no access to cheaper U.S. product, consumers are returning to the legal market. With the gradual re-opening of reserves to non-residents and the anticipated eventual re-opening of the Canada-U.S. border, illicit importation and resale of U.S. smokeless

[1] NSTC, November 2017.

tobacco products will likely resume. Government can take steps to prevent this resumption through a revised tobacco tax policy.

Tobacco and Nicotine Products: An Evolving Market

The tobacco retail marketplace has undergone fundamental change in recent years with the introduction of numerous novel products. As noted by the Ontario Chamber of Commerce, "[t]ransformations in product offerings and consumer habits have led to an environment where both regulation and cessation supports are increasingly out of date. As tobacco and vaping products evolve, it is imperative that federal and provincial government regulations, taxes, and cessation programs keep pace."[2] Taxation and public health strategies must be tailored to specific product categories in order to effectively address public health goals. There cannot be a one-size-fits-all approach to tobacco product regulation or taxation.

Recommendations

1. Modernize the *Excise Act, 2001*

Legislation must be updated to accurately reflect the current marketplace.

OUTCOME: All tobacco and vapour products on the market in Canada will be clearly defined and can be taxed according to how they are packaged, sold, and consumed.

Canada has an outdated tobacco tax structure with five tobacco tax categories, "cigarettes", "tobacco sticks", "manufactured tobacco", "cigars", and "raw leaf tobacco". Products taxed in the overly broad "manufactured tobacco" category include:

- combustible roll-your-own tobacco
- combustible pipe tobacco
- non-combustible smokeless tobacco
- non-combustible heated tobacco products

Each of these products is unique and consumed differently, yet all are taxed in the same category at the same rate. The existing federal tobacco tax structure does not allow for deliberate, focused tax rate changes to any single product within the category. It should also be noted that novel categories like vapour products and heated tobacco products are not defined in the Act.

Each distinct product in the existing "manufactured tobacco" category should be in a separate tax category to allow the government precision in its tobacco tax policy and administration. Additionally, the "tobacco sticks" category should be eliminated. In its 2019 update to the federal Tobacco Reporting Regulations, Health Canada removed "tobacco sticks" as a reportable sales

[2] Ashley Challinor, Vice President, Policy, Ontario Chamber of Commerce, "Final Report in Social Responsibility Series Examines Tobacco and Vaping Products," December 19, 2019 available at https://occ.ca/mediareleases/final-report-in-social-responsibility-series-examines-tobacco-and-vaping-products/.

category recognizing the evolution of tobacco products offered for sale in Canada, yet it is still referenced in the *Excise Act*.

Tobacco tax categories in the *Excise Act* should include:

Combustible Products	Non-combustible Products
1. Cigarettes	5. Smokeless tobacco
2. Roll-your-own tobacco	6. Heated tobacco products
3. Pipe tobacco	7. Vapour products
4. Cigars	

The Ontario Chamber of Commerce recently recommended that updates be made to the Federal *Excise Act 2001* and to Ontario's *Tobacco Tax Act*. The recommendation reads:

> The Government of Canada and Government of Ontario should ensure that tax policies are responsive to new products available on the market and reflect the distinction between combustible and non-combustible products. Specifically:
>
> - The federal government should amend the *Excise Act, 2001* and the provincial government should amend the *Tobacco Tax Act, 1990* to create separate tax categories for tobacco products that fall within the current manufactured tobacco category—pipe tobacco, roll-your-own tobacco, smokeless tobacco, and heat-not-burn products; and
>
> - The federal and provincial governments should tax smokeless tobacco products and heat-not-burn products based on the weight of the tobacco mixture contained within the device.[3]

Other governments have acted to ensure that appropriate tobacco tax structures are in place. Saskatchewan took the first step towards reforming its *Tobacco Tax Act* in 2017 by creating a separate tax category for smokeless tobacco products, distinct from roll-your-own tobacco for smoking, pipe tobacco, and heated tobacco products[4]; Manitoba taxes smokeless tobacco at a different (and lower) rate than roll-your-own tobacco for smoking[5]; Nova Scotia taxes roll-your-own tobacco for smoking in a different category than smokeless tobacco; and Nunavut has distinct tax categories for "smoked tobacco" (40 cents/g) and "non-smoked tobacco" (30 cents/g).[6] Finally, the government of Alberta is currently reviewing its tobacco tax categories for precision and alignment with the retail marketplace.

At a national level, the U.S. has eight different federal tax categories for tobacco products.[7]

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[3] Guiding Policy Principles for Tobacco and Vaping Products, Ontario Chamber of Commerce, December 2019

[4] An Act to amend The Tobacco Tax Act, available at https://pubsaskdev.blob.core.windows.net/pubsask-prod/98779/Bill-57.pdf.

[5] Government of Manitoba tobacco tax rates, available at https://www.gov.mb.ca/finance/taxation/taxes/tobacco.html.

[6] Nunavut tax rate sheet, available at https://gov.nu.ca/sites/default/files/nunavut_tax_rate_sheet_2020-eng.pdf.

[7] U.S. Department of the Treasury, Alcohol and Tobacco Tax and Trade Bureau https://www.ttb.gov/tax-audit/tax-and-fee-rates

2. Eliminate the 50-gram increment rate calculation for smokeless tobacco products and tax these products based on actual weight, per gram

A product sold only in formats less than 50 grams should not be subject to a tax rate calculated in 50-gram increments.

OUTCOME: Smokeless tobacco products will be taxed according to their actual weight.

The FET on manufactured tobacco products is calculated in 50-gram increments, yet no 50-gram smokeless tobacco product is available for sale in Canada. In the case of NSTC's standard 34-gram format, adult smokeless tobacco consumers are paying FET on 16g of product that they are not in fact purchasing. In the case of lighter selling units, like the 23-gram pouch format, the tax burden is even more significant.

Smokeless tobacco should be taxed per gram. The biggest factor impacting price and illicit market sales of smokeless tobacco is the disproportionate federal tax burden on this category. A per gram calculation would help to mitigate consumer shifts from legal to unregulated markets.

Changes to tax stamping requirements would be minor and would be at no cost to the federal government. All tax stamping costs are borne by the manufacturer. There are currently no provincial tax stamping requirements for smokeless tobacco products and one federal stamp is used for the category. One stamp could continue to be used for the entire smokeless tobacco category with a per gram tax calculation, and no changes to reporting requirements or enforcement policies would be required.

3. Tax non-combustible products at lower rates than combustible products

There is overwhelming consensus that the consumption of non-combustible forms of tobacco is substantially less hazardous to health than smoking cigarettes.

OUTCOME: Canada's tobacco tax policy will "actively encourage those who cannot quit tobacco use to switch completely to less harmful products", consistent with Canada's stated public health approach on tobacco policy.[8]

The public health consensus on the consumption of non-combustible tobacco products is based on extensive scientific research and evidence shared by many global public health organizations including the World Health Organization, the European Commission's Scientific Committee on Emerging and Newly Identified Health Risks, and the United Kingdom's Royal College of Physicians. Canada should adopt a risk-based approach to tobacco taxation that recognizes the relative health risks associated with the use of combustible versus non-combustible products

All tobacco products in Canada are highly taxed, and, as noted by Health Canada, "increasing the price of tobacco products has also contributed to reductions in the number of people who

[8] Health Canada, *Seizing The Opportunity: The Future Of Tobacco Control In Canada*, February 2017, available at https://www.canada.ca/en/health-canada/programs/future-tobacco-control/future-tobacco-control.html?utm_source=news.gc&utm_medium=news_release_link_en&utm_content=link2&utm_campaign=tobacco_17, p 12.

smoke."[9] This suggests that tax policy can play a role in transitioning adult tobacco consumers who choose to continue using tobacco products to less harmful non-combustible products. Yet the combustible cigarette, the most harmful tobacco product on the market in Canada, is the cheapest. Given existing high tax rates on all tobacco products, the government should not increase any tobacco taxes. It is well-documented that high tax rates drive consumers to unregulated markets where there is ready access to untaxed and unregulated products at significantly lower prices. Policy goals should be accomplished by lowering the tax on non-combustible tobacco products relative to combustible products.

Conclusion

In developing an effective economic recovery plan for Canada in Budget 2021, the government must consider all aspects of federal taxation and regulation, including tobacco taxation and measures to combat unregulated and illicit tobacco sales. This starts with developing a modern tobacco tax system that reflects the current marketplace and applying tax rates that are specific to distinct product categories.

Experts agree that non-combustible tobacco presents significantly less risk than cigarette smoking, which is the overwhelming cause of tobacco-related harm. Despite this fact, cigarettes are more affordable and therefore more accessible than non-combustible products in Canada because they are subject to a much lower FET rate. The FET charged on a pack of cigarettes is $3.11, whereas the FET charged on a can of smokeless tobacco is $7.76.

Lowering the FET rate on smokeless tobacco products and taxing these products per gram could result in a reduction in smoking-related morbidity and mortality. It could also ensure that more Canadian tobacco consumers make their tobacco purchases in legal retail channels rather than unregulated markets.

[9] *Id.* at 11.