



**IMPERIAL TOBACCO
CANADA**

August 12, 2011

Ms. Guyanne Desforges
Clerk, House of Commons Standing Committee on Finance
6th Floor, 131 Queen Street
House of Commons
Ottawa, Ontario
K1A 0A6

Dear Ms. Desforges:

Please find attached the pre-budget submission of Imperial Tobacco Canada Limited (ITCAN). We are happy to provide the Committee with additional information about our submission if requested. Likewise, we are available to appear before the Committee if there is a desire to learn more about Canada's illegal tobacco crisis.

Please let me know if you have any questions. Thank you for your time and consideration.

Sincerely,

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encl.

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**Pre-Budget Submission to the
House of Commons Standing Committee on Finance**

August 12, 2011

Executive Summary

It is time for action to fight Canada's illegal tobacco crisis. Contraband has made up 16.5% to 32.7% of the market since 2006. Illegal tobacco is being produced in 50 unlicensed and unregulated cigarette factories on Canadian soil. It is then sold in over 300 smoke shacks located on First Nations reserves or through criminal distribution networks that are run by organized crime groups.

Illegal tobacco is costing Governments \$1.5 billion in lost tax revenue annually, with \$600 million lost to the Federal Government alone each year. This lost tax revenue takes on a new dimension as the Government launches its Strategic and Operating Review, which seeks to cut \$11 billion in spending over the next four years. If action was taken to shut down the illegal tobacco trade, the Federal Government would recoup \$2.4 billion over the same period – or more than 20% of the spending that needs to be cut.

Fighting illegal tobacco is primarily a matter of political will. All the tools needed to do so are already at the Government's disposal. Given the current focus on spending cuts and deficit fighting, there is perhaps no better time to make a concerted effort to end the illegal trade.

Recommendations to Fight Illegal Tobacco

- 1. Do not raise taxes on tobacco products.* The primary driver for the growth of contraband is the fact that illegal cigarettes are much cheaper than legal product. High tobacco taxes are not an effective deficit fighting measure since they stimulate the illegal trade which ultimately robs Governments of expected tax revenues.
- 2. Shut down the illegal cigarette factories or bring them under the law.* This is simply a matter of political will. No new legislative or enforcement powers are needed and the locations of the factories are well-known. Not one illegal cigarette factory or smoke shack has been shut down since the launch of the RCMP Contraband Tobacco Enforcement Strategy in May 2008 – despite this being identified as a critical aspect of combating the illegal trade.
- 3. Enhance border security.* Large amounts of illegal tobacco still enter Canada from the United States, particularly along the St. Lawrence River between Cornwall and the Montreal area. Border security in this region should be enhanced. Also, the Cornwall port of entry should be permanently located in the City of Cornwall.
- 4. Introduce legislation to act on election promises.* The Conservatives promised new measures on contraband in their 2011 platform. We encourage the Government to move forward quickly to act on those.
- 5. Invest in a public education campaign.* Despite promises of such a campaign, Government efforts in this area are minimal. We believe there are a significant number of consumers of contraband who will cease to purchase such product if made aware of the potential criminal penalties.

Introduction

By now most Finance Committee Members should be well-versed on the realities of Canada's illegal tobacco crisis. It continues to be one of Canada's greatest public policy failings, with a massive illegal trade that funnels billions of dollars away from Governments and into the pockets of organized crime.

Despite Governments at all levels knowing about this crisis for several years, there has been remarkably little action, with the excuse usually tied to the "sensitivities" of dealing with First Nations issues in this country. However, failure to act now takes on a new dimension given the Strategic and Operating Review, which seeks to cut \$4 billion in annual spending by 2014 and a cumulative total of \$11 billion over the next four budgets. Based on our estimates calculated from public sources, Governments lose approximately \$1.5 billion in tax revenue annually to the illegal tobacco trade.¹ This means that by 2014, taxpayers in Canada will be robbed of over \$6 billion. The federal government alone loses \$600 million annually, for a total of \$2.4 billion over the next four years.² By comparison, our company paid \$1,571,541,345.76 in federal taxes in 2010 (payroll tax, GST, corporate income tax, excise and duty paid).

As a result, the Government is now faced with a difficult public conversation: cut \$11 billion of programs and potentially the jobs that go with them over the next four years while doing nothing to shut down the illegal tobacco trade that will rob taxpayers of billions of dollars and further enrich the organized crime groups that are behind the trade.³ The lost federal tax revenue to the illegal tobacco trade over the next four year (\$2.4 billion) represents more than 20% of the amount the Government hopes to cut – making it difficult to continue ignoring.

The actions required are simple: the Federal Government needs to exercise its powers and enforce existing laws on the 50 illegal cigarette factories operating in Canada and the over 300 smoke shacks located on First Nations reserves selling tobacco while disregarding the existing legal and tax framework.⁴ No legislative or regulatory changes are needed to do so. It is simply a matter of exerting the political will to enforce existing laws.

For that to happen, all parties need to support the rule of law and protection of taxpayer interests over the convenient shroud of political correctness as an excuse for inaction. There is \$600 million available annually if the Government chooses to act.

¹ This figure is calculated based on the level of illicit trade in 2010 from GfK Research 2010 and PTT Revenue is sourced from the Government Budget documents (Government Year-end March 31st, 2010).

² This figure is an estimate calculated based on the level of illicit trade in 2010 from GfK Research 2010 and PTT Revenue is sourced from the Government Budget documents (Government Year-end March 31st, 2010).

³ RCMP Contraband Tobacco Enforcement Strategy, 2008

⁴ Testimony to the House of Commons Standing Committee of Public Safety and National Security, April 27, 2010

About Imperial Tobacco Canada Limited

Established in 1908, Imperial Tobacco Canada Limited (ITCAN) is Canada's leading tobacco company, offering brands like du MAURIER, Player's, Peter Jackson and Vogue to over five million adult Canadians who chose to smoke. ITCAN is headquartered in Montreal and employs 650 people across Canada.

ITCAN is dedicated to conducting its business responsibly, in a manner that meets society's expectations of major corporations. ITCAN is a law abiding corporate citizen that strictly follows over 200 laws and regulations that govern the tobacco industry and pays all required taxes. Unfortunately, the Canadian tobacco market is being taken over by an illicit trade which funds organized crime⁵ – and those who sell illegal tobacco abide by a completely different set of rules.

Canada's Illegal Tobacco Crisis

Contraband has made up 16.5% to 32.7% of the market nationally since 2006. Illegal tobacco sales appeared to peak in 2008, hitting 48.6% of the market in Ontario and 40.1% in Quebec.⁶ Illegal tobacco is produced in unlicensed and unregulated factories on First Nations reserves in Canada and the United States. The RCMP has reported there are 50 illegal cigarette factories operating on reserves in Ontario and Quebec and another 8-10 on reserves in New York State that are supplying the illegal market in Canada.⁷

Illegal cigarettes are sold through two main channels. First, there are over 300 unregulated "smoke shacks" on reserves.⁸ Many of these smoke shacks receive illegal cigarettes directly from the factory.⁹ Second, organized crime networks have sophisticated distribution networks to deliver illegal cigarettes from reserves to communities across the country. According to the RCMP, there are more than 175 organized crime groups involved in this illegal trade.¹⁰ These groups also traffic drugs and arms and there have been reports that profits from the sales of illegal cigarettes may fund international terrorist organizations.¹¹ Seizures of these illegal cigarettes have been reported as far east as Newfoundland and as far west as British Columbia.

⁵ *RCMP Contraband Tobacco Enforcement Strategy, 2008*

⁶ *See Illicit usage of cigarettes – National Study for the CTMC, GfK Research Dynamics, 2007, 2008, 2010*

⁷ *Testimony to the House of Commons Standing Committee of Public Safety and National Security, April 27, 2010*

⁸ *RCMP Contraband Tobacco Enforcement Strategy, 2008*

⁹ *The Canadian Convenience Stores Association has done an excellent job documenting these smoke shacks. See for example an ad campaign in The Hill Times newspaper in the first quarter of 2011.*

¹⁰ *Testimony to the House of Commons Standing Committee of Public Safety and National Security, April 27, 2010*

¹¹ *Black-market smokes could finance terrorists: RCMP, Canwest News Service, October 27, 2009*

It is estimated that Federal and Provincial Governments lose over \$1.5 billion annually in tax revenue to the illegal trade.¹² The Auditor General of Ontario estimated in a 2008 report that Ontario's tax losses to illegal tobacco "could well be in the \$500 million range in 2006/2007."¹³ In addition, in March 2010 the Quebec Government confirmed it is losing \$300 million in tax revenue annually to the illegal tobacco trade and has since taken measures to deal with this tax evasion.¹⁴ At a time of deficit fighting and budget cuts, this lost tax revenue should be of paramount concern to the Finance Committee.

Recommendations

In light of the above, please find below our recommendations for the 2012 Federal Budget.

1. Do not raise taxes on tobacco products. The primary driver for the growth of contraband is the fact that illegal cigarettes are much cheaper than legal product: 200 illegal cigarettes in a transparent plastic baggie sell for as little as \$10 in some provinces compared to approximately \$55-125 for the same number of legal ones. In these conditions the incentive for consumers to purchase illegal cigarettes is significant, as validated in a report by the Fraser Institute that found high taxes "create powerful incentives to buy and sell contraband tobacco products."¹⁵ Increases to the federal tobacco excise duty stimulate the illegal trade, while reductions have the opposite effect, as displayed in recent Canadian history and recounted in the report.

Besides providing Governments with a secure, predictable and easy to collect source of revenue, tobacco taxes are also used by Governments as a policy instrument to discourage tobacco consumption.¹⁶ However, the study found that both goals are being compromised by the illegal trade.¹⁷ For example, in some provinces tobacco tax revenues declined even though taxes increased and smoking rates remained constant or increased. This can only be explained by the explosive growth of the illegal tobacco trade. In other words, the same number of people were smoking, but because they were buying cheaper illegal products no taxes were collected. In short, raising tobacco taxes is not an effective deficit-fighting measure. However, shutting down the illegal trade would be.

2. Shut down the illegal cigarette factories or bring them under the law. No new legislative or enforcement powers are needed. The factory addresses are well-known. Shutting them down is simply a matter of exerting political will to apply existing laws. That should be an easier decision given the need to cut \$4 billion from Government spending and balance the budget

¹² This figure is calculated based on the level of illicit trade in 2010 from GfK Research 2010 and PTT Revenue is sourced from the Gov't Budget documents (Government Year end March 31st, 2010)

¹³ Ontario Auditor General Annual Report, 2008

¹⁴ 2010 – 2011 Budget – Choices for the Future – Economic and Budgetary Action Plan (Quebec)

¹⁵ Contraband Tobacco in Canada: Tax Policies and Black Market Incentives, Fraser Institute, July 2010

¹⁶ The Illicit Trade in Tobacco Products and How to Tackle It, International tax and Investment Center, 2010

¹⁷ Contraband Tobacco in Canada: Tax Policies and Black Market Incentives, Fraser Institute, July 2010

while knowing that there is at least \$600 million lost annually to the illegal tobacco trade – or approximately \$2.4 billion over the next four years.

The Federal Government must exercise its responsibilities and inspect companies that have been issued a tobacco manufacturing license. It is our understanding that Health Canada and Revenue Canada are not doing so for licensed tobacco manufacturers on First Nations reserves. These manufacturers may be operating illegally, in blatant disregard of legal requirements, without any legal repercussions whatsoever. Finally, it is worth noting that since the launch of the RCMP Contraband Tobacco Enforcement Strategy in May 2008, not one single illegal cigarette factory or Native smoke shack has been shut down – this despite \$20 million being allocated to the strategy and it being identified as a critical aspect of combating the illegal trade.¹⁸

3. Enhance border security. Large amounts of illegal tobacco products are still entering Canada from First Nations reserves on the U.S. side of the border in Ontario and Quebec. Furthermore, if the Government is successful in shutting down the illegal factories operating on Canadian soil, you can expect the illegal operators to shift more production to the U.S. Therefore, the Government should immediately re-introduce and pass the Shiprider legislation that allows for joint Canada-U.S. law enforcement cooperation along the border.

Additional resources should also be allocated to border security on the primary smuggling routes along the St. Lawrence River from Cornwall to the greater Montreal area. Lastly, the Canada Customs post in Cornwall/Akwesasne must be permanently located in the City of Cornwall as any other option will make it vastly easier to ship contraband into Canada.

4. Introduce legislation to act on election promises. The 2011 Conservative election platform contained two promises on contraband: the establishment of mandatory jail time for repeat offenders and a new RCMP anti-contraband force of 50 officers. We encourage the Government to move forward quickly to enact this promise and ask all parties to support it.

5. Invest in a public education campaign. There have been several promises of a public education campaign on illegal tobacco as part of the Government's strategy to fight contraband. After three years of promises and with \$20 million at its disposal for such a campaign (as part of the money allocated to the RCMP Strategy), the end result has been strikingly minimal. There has been no sustained effort to educate the public about the ills of illegal tobacco, the penalties associated with its use, or its link to organized crime.

¹⁸ *In testimony to the House of Commons Public Safety Committee on April 27, 2010, the RCMP conceded they had not shut down any illegal factories. ITCAN is not aware of any illegal smoke shacks being shut down either and can find no evidence of such.*

We have reason to believe that there are a significant number of consumers of contraband tobacco who will cease to purchase such product if they were aware of the potential criminal penalties that are attached to buying it. There is clearly a role here for the Federal Government to fill the public education void.

Illegal Tobacco Trade and the Pre-Budget Priorities

Of the priority issues in the Pre-Budget consultation, our recommendations are most relevant to achieving a balanced budget. Governments are currently losing approximately \$1.5 billion annually in tax revenue to the illegal trade. The measures we propose have minimal costs and will pay for themselves many times over as Governments recoup lost tax revenue. Moreover, by acting to shut down the illegal tobacco trade, all parties can avoid the difficult public conversation that would ensue if \$4 billion in program spending was cut while the illegal trade continues to operate with impunity and rob the Federal Government of \$600 million annually.

While increased tax revenue is the primary benefit, the Committee cannot overlook the impact of the illegal trade on law-abiding business. Our company alone is losing hundreds of millions of dollars annually to the illegal trade, which costs jobs and tax revenue. Convenience stores are also being devastated. In April 2010 the vice president of Quickie Convenience Stores stated that 1,500 corner stores have gone out of business in Ontario “because of the loss of sales to contraband tobacco.”¹⁹ The Canadian Convenience Stores Association reported that 2,300 stores closed in 2009 and put the blame squarely on illegal tobacco.²⁰ The hard-working convenience store owners are victims of Government inaction, with jobs lost and lives ruined.

Finally, this submission does not even begin to address the fact that the illegal trade undermines every single tobacco control policy that Governments have put in place.

Conclusion

There is no better time to finally shut down Canada’s illegal tobacco trade. In a period of deficit-fighting and program cuts, there will be minimal public opposition to shutting down illegal cigarette factories that are robbing Governments and taxpayers of billions in revenue annually. The Committee also cannot lose sight of the fact that over the next four years, shutting down the illegal tobacco trade would deliver \$2.4 billion in new tax revenue – or more than 20% of the spending that needs to be cut under the Strategic and Operating Review.

¹⁹ *Crack down on illegal smokes, Waterloo Region Record, 19 May 2010*

²⁰ *CCSA, State of the Industry report, 2010 Edition*

We recognize that illegal factories will not be shuttered overnight. However, it is time to begin the process. Coupled with the other recommendations listed here, the Government can begin to tackle Canada's illegal tobacco crisis.

In closing, we recommend the words of Senator Hugh Segal in describing the need to act:

It is easy, honourable senators, to look away from contraband tobacco as simply one of those things by which we should not be troubled. However, honourable senators, consider this: If we do not act, we avert our eyes from an illegal activity that harms young people, reduces tax revenues, hurts First Nations, hurts the credibility of the police, harms our health care system and population health, hurts small business and hurts the very integrity of our borders. That illegal activity enriches criminal biker networks, illegal manufacturers and terrorist, prostitution and illegal drug networks. These are networks that use illegal arms to prey upon and, when necessary, simply eradicate citizens who stand in their way. If we permit all of this happen, we are saying that the rule of law — fundamental to how a democracy balances freedom and order — is actually negotiable, or worse, a side-car afterthought.²¹

²¹ Speech by The Honourable Senator Hugh Segal, Senate of Canada, 12 May 2010