August 1, 2014

Improving Canada's Tobacco Tax Regime

National Smokeless Tobacco Company Pre-Budget Submission to the Government of Canada

Executive Summary

In Canada's Economic Action Plan 2013, the federal government announced an 84% federal excise tax (FET) increase on smokeless tobacco products. At the time, the Government of Canada stated that the increase was intended to address "the preferential excise duty treatment of manufactured tobacco."[1] This was followed by an FET increase of 24% in Economic Action Plan 2014 "to restore the effectiveness of the excise duty on tobacco products."[2]

In practice, these moves widened the already significant price gap between smokeless tobacco and cigarettes. The current average suggested retail price for smokeless tobacco products in Canada is $23.00 (exclusive of GST and other applicable sales taxes), which is almost double the price of a package of premium cigarettes.

Not only were these tax increases unfair to adult tobacco consumers, retailers and wholesalers of smokeless tobacco products, they also created a scenario where it is cheaper for adult tobacco consumers to purchase cigarettes than non-combustible tobacco products, such as smokeless tobacco. From a policy standpoint, this outcome should be of concern to the Government of Canada. There is an overwhelming scientific, medical and public health consensus that the consumption of non-combustible forms of tobacco is substantially less hazardous to health than smoking cigarettes. This consensus is based on extensive scientific research and evidence and is 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. With significant tax disparities existing between different tobacco products, the government risks the unintended consequence of encouraging adult tobacco consumers to use smoked tobacco products over non-combustible tobacco products.

In this submission, National Smokeless Tobacco Company (NSTC) is proposing that the Government of Canada reform its tobacco tax categories to more accurately reflect the current tobacco retail market in Canada. The result would be a modern tobacco tax system that would provide the government with the ability to more accurately categorize tobacco products currently available for sale in Canada, as well as any new products that may enter the marketplace in the future. In addition, by refining tobacco tax categories based on unique products' qualities, and by applying distinct tax rates to each, the government would have the flexibility to adopt a risk-based approach to tobacco taxation.

[1] The Government of Canada's Economic Action Plan 2013
[2] Economic Action Plan 2014

Background

NSTC is the Quebec-based Canadian distributor of smokeless tobacco products manufactured under the brand names Copenhagen and Skoal. Our products are sold in approximately 12,000 independent and chain retail locations in Canada and are distributed through more than 200 individual shipping points across the country.

NSTC's products are used orally and are not smoked. At retail, these products are available in 14 gram, 23 gram and 34 gram formats; the majority of NSTC's sales volume is in the 34 gram format. In North America, the 34 gram format is the most commonly manufactured size of smokeless tobacco product available at retail. Smokeless tobacco has been sold in Canada for more than a century, and for the year ended December 31, 2012, represents one half of one percent of the total volume of all categories of tobacco products sold in Canada.[3]

The Government of Canada currently has five categories for tobacco products subject to federal tax under the *Excise Act, 2001*. These categories are:

- Cigarettes;
- Tobacco sticks;
- Manufactured tobacco other than cigarettes or tobacco sticks;
- Cigars; and
- Raw leaf tobacco.

Manufactured tobacco is defined as "every article, other than a cigar or packaged raw leaf tobacco that is manufactured in whole or in part from raw leaf tobacco by any process."[4] This tax category includes smokeless tobacco, a non-combustible oral tobacco product, and fine-cut tobacco that is used by individuals who roll their own cigarettes for smoking. Smokeless tobacco represents approximately one-third of this category.

Prior to July 1, 2008, manufactured tobacco products were subject to a pro rata tax calculation (per gram) regardless of package size. This changed with the implementation of Budget 2008 which eliminated the pro rata calculation and introduced a tax rate based on 50 gram increments (or fraction thereof). Thus, the tax on all manufactured tobacco products is calculated in 50 gram increments despite the differences between smokeless tobacco products and roll-your-own tobacco for smoking within this tax category. In the case of smokeless tobacco products, no 50 gram product is available in Canada. Even with the purchase of the largest size format available (34 grams), the adult smokeless tobacco consumer is paying an extra $2.10 in FET and essentially being taxed for 16 grams of tobacco product that they are not in fact not purchasing.

No other tobacco product in Canada has a weight-based tax applied to it where there is no relationship between how the product is packaged and how its tax is calculated.

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[3] Health Canada Wholesale sales data 2012, NSTC sales data, 2012
[4] Excise Act, 2001

Smokeless tobacco products are faced with a tax disadvantage compared to other tobacco products based solely on their inclusion in the manufactured tobacco category.

It is important to note that the manufactured tobacco category is in overall decline in Canada. Category volume has shrunk by more than 50% over the past decade from more than 2.4 million kilograms in 2004 to less than one million kilograms in 2012.[5] Within the manufactured tobacco category, smokeless tobacco makes up a larger component of a shrinking category, yet it is still subject to federal tax policy that is focused on tobacco for smoking and is not reflective of the different nature of smokeless tobacco products.

In Economic Action Plan 2013, the Government of Canada increased the FET on manufactured tobacco from $2.8925 to $5.3125 per 50 grams or fraction thereof. According to the government, this put the excise tax rate for manufactured tobacco on par with the excise tax on cigarettes. While this may be the case for roll-your-own tobacco for smoking, this assessment is categorically inaccurate for smokeless tobacco products, and is inconsistent with the disproportionate FET now applied to smokeless tobacco products. Economic Action Plan 2014 compounded this tax inequality with a further increase on the manufactured tobacco tax from $5.3125 to $6.57188 per 50 grams or fraction thereof. The result is a 127% FET increase on smokeless tobacco products in a period of less than 12 months, solely due to their inclusion in the same category as roll-your-own tobacco for smoking.

Recommendation

The Government of Canada should modernize and update its tax categories for tobacco products. Distinguishing between different tobacco products through unique tobacco tax categories would add precision and fairness to the government's tobacco taxation efforts, better reflecting current product manufacturing and the variety of tobacco products available for sale in Canada, and would allow tax authorities appropriate flexibility and clarity in tobacco tax policy.

NSTC supports a differentiation in tax categories for tobacco products that more accurately reflects the differences between tobacco products in the marketplace today. Smokeless tobacco products are faced with the burden of being taxed in the same manner as completely unrelated and incongruent products. It is NSTC's position that similar products should be taxed similarly, but different products should be taxed differently.

The United States, the world's largest market for smokeless tobacco,[6] uses 10 distinct federal tax classifications for tobacco products, including classifications specifically for "chewing tobacco" and "snuff" that are separate and distinct from loose tobacco for smoking.[7] Sweden, which is the world's second-largest market for smokeless tobacco,[8]

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[5] Source: Health Canada Wholesale Sales Data, 2012: http://www.hc-sc.gc.ca/hc-ps/tobac-tabac/research-recherche/indust/_sales-ventes/canada-eng.php
[6] Source: Euromonitor International, 2013
[7] Source: U.S. Alcohol and Tobacco Tax and Trade Bureau http://www.ttb.gov/main_pages/schip-summary.shtml
[8] Source: Euromonitor International, 2013

also distinguishes "chewing tobacco" and "snuff" from other tobacco products like cigarettes, cigars, and smoking tobacco (roll-your-own and pipe tobaccos).[9]

There is precedent within Canada for a wider range of tobacco tax categories. In Nova Scotia, there is a tax policy distinction made between smokeless tobacco and other tobacco products. Since at least 1994, Nova Scotia has taxed cigarettes, cigarette tobacco, tobacco sticks and cigars at a different rate than chewing tobacco, snuff, pipe tobacco and unprocessed tobacco leaf.[10]

NSTC proposes that the Government of Canada redefine its tobacco tax categories to recognize that smokeless tobacco is a different product than loose tobacco that is used for roll-your-own cigarettes, and that distinct tax rates be applied to each category.

By establishing distinct tax categories, Canada's tobacco tax policy would more accurately reflect the current tobacco product marketplace, and the government would be able to more effectively categorize new tobacco products that may be introduced in the future.

Fiscal Impacts

The proposed changes to Canada's tobacco tax categories made in this submission would not have a net fiscal impact on the Government of Canada.

These measures would also help mitigate contraband concerns. Large excise tax increases create significant financial incentives for criminals to engage in illicit activity – activity that undermines tax revenues and hurts law-abiding businesses. It is the government's responsibility to make policy decisions that deter, not encourage, illicit activity. The current price gap between Canadian and U.S. smokeless tobacco products can be a difference of more than four-fold, depending on the province and U.S. state.[11] This is a significant differential that the Government of Canada contributed to with its recent FET increases.

Health Policy Impacts

The Government of Canada should also consider the potential health policy impacts of these proposed changes to Canada's tobacco tax categories. There is an overwhelming scientific, medical, and public health consensus that smokeless tobacco products, including those widely available in North America and Sweden (snuff and snus), are substantially less hazardous than cigarettes. Transitioning adult smokers from cigarettes to demonstrably less hazardous smokeless tobacco products could impact smoking cessation (number of years smoked), thereby reducing risk and harm.

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[9] Source: Swedish Ministry for Foreign Affairs: http://www.government.se/content/1/c6/07/31/94/598dfd51.pdf
[10] Source: Nova Scotia Ministry of Finance
[11] Source: NSTC, Altria internal sales data. Based on 2014 NSTC suggested RSP of $25.89 +GST of smokeless tobacco products in Alberta vs. US$6.00 average price of premium smokeless tobacco products in Montana.

The government's failure to recognize the unique nature of different tobacco products in current tobacco tax categories has resulted in significant tax disparities. Consequently, the higher cost of smokeless tobacco makes cigarette smoking a more affordable option for adult tobacco consumers and may have the unintended consequence of encouraging those adult tobacco consumers who wish to continue to use tobacco products to use cigarettes over less hazardous forms of tobacco, such as smokeless tobacco.

Administrative Impacts

Taxes would still be collected and remitted in the same manner as they are currently if these proposed changes were implemented. No administrative changes would be required beyond the introduction of a new category identifier code for tax collection documentation.

The production of new tax stamps to distinguish between tobacco categories would be required upon implementation of the new categories. The costs of tax stamping are already borne by manufacturers with no cost burden on the government.

Summary

The Government of Canada has the opportunity to modernize its current tobacco tax categories to better reflect the variety of tobacco products on the market today. There are precedents for this modernization. This modernization would entail a change to the existing manufactured tobacco category, breaking it into new and distinct categories which recognize the unique nature of different tobacco products. These changes would also give the government the flexibility to adopt a risk-based approach to tobacco taxation, recognizing the different health risks associated with different tobacco products.

Making the tax category changes outlined above would be relatively simple, and would result in a modern tobacco tax system that would give the government increased flexibility to accurately categorize existing and new products. These changes would bring Canada in line with other jurisdictions that have acted to ensure precision in their tobacco tax systems and provide greater clarity to federal tobacco tax policy.

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