

Part 3

How Tobacco Products are Taxed in Canada

Several legal instruments are used to impose taxes on tobacco products and on their manufacturers and purchasers at the provincial, territorial and federal levels.

At the federal level, the following taxes are applied¹⁷:

The *Excise Act* imposes duties at various unit rates on domestically produced tobacco products. Excise duties are imposed on cigarettes, cigars, tobacco sticks, other forms of manufactured tobacco and raw leaf tobacco at the time these products are packaged for consumption.

The *Excise Tax Act* imposes excise taxes on both imported and domestic tobacco products at a unit rate, and at an ad valorem rate for cigars. These sales levies are imposed at the time the manufacturer delivers the goods to a purchaser, and must be remitted at the end of the month following the month the tax is imposed, with more frequent remittance by large manufacturers. An Excise Tax is also imposed on exports of tobacco, subject to certain exemptions.

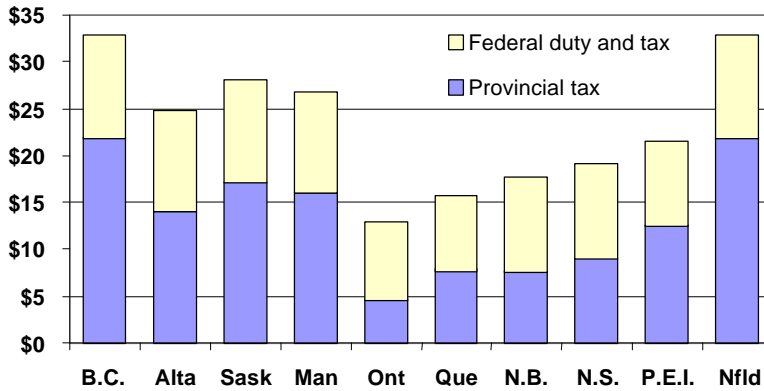
The *Excise Tax Act* also imposes a 7% Goods and Services sales tax on the sale of tobacco products.

The Customs Tariff imposes customs duties on imports equivalent to the excise duties that are imposed on domestically produced tobacco products.

Provincial and territorial government taxes on tobacco are usually imposed through provincial/territorial tobacco tax acts. Most provinces also impose sales taxes on cigarettes. The rates of taxation in these provinces have historically varied, but the disparities increased dramatically after 1994.

¹⁷ The description of tobacco taxes is taken from Excise Tax Review, Finance Canada, February 1997.

Figure 5
Tobacco Taxes on Manufactured Cigarettes



Sources: See data in Appendix A, Table A. This does not include GST or provincial sales tax.

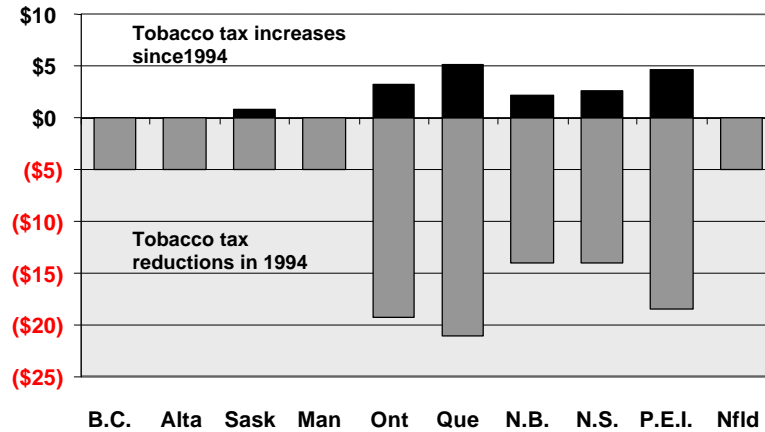
Before 1994, the federal excise tax and duties were the same in every Canadian province. On February 8, 1994, the federal government reduced excise tax rates on most tobacco products by a base amount in every province, and made subsequent additional cuts in Ontario, Quebec, New Brunswick, Nova Scotia and Prince Edward Island to match provincial tobacco tax reductions.

Since 1994, there have been only three rounds of tax increases in the ‘low-tax’ provinces, resulting in federal tax increases of the following amounts (these were roughly matched by provincial tax increases) :

- February 1995 \$0.60
 (matched in Quebec only; the matching increase in Ontario was not implemented)
- November/December 1996 \$0.70
 (Ontario, Quebec, New Brunswick, Nova Scotia, Prince Edward Island)
- February 1998 \$0.60
 (Ontario, Quebec, Nova Scotia, PEI);
 \$0.40
 (New Brunswick)

These modest tax increases have done little to restore equal tax rates across Canada.

Figure 6
Taxes increases and decreases since 1994



Sources: See data in Appendix A, Table I.

Inflation Reduces Tobacco Taxes Invisibly

The unit-based taxes imposed on tobacco products do not increase automatically with changes in the cost of living in the same way that ad valorem taxes do. As a result, the absence of any tax increase on unit-based taxes during a period of even low inflation results in a *de facto* tax cut.

When cost-of-living adjustments are considered, taxes on tobacco products are 7% lower in the summer of 1999 than they were in the summer of 1994 in the five ‘high-tax’ provinces. In the five ‘low-tax’ provinces, the real price of tobacco products has increased by only a modest 0% to 8% (see Figure 8).

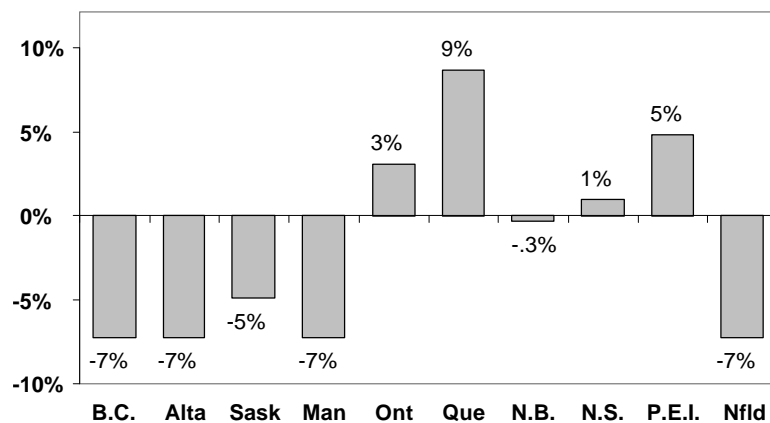
The largest increase in taxes since 1994 has been in the province of Quebec, where joint federal-provincial tax increases have raised the price of cigarettes by \$5.08 per carton. In Prince Edward Island, the increase has been \$4.60 per carton, in Ontario only \$3.20 per carton. New Brunswick and Nova Scotia trail at \$2.20 and \$2.60 respectively. Among the provinces which did not reduce taxes in 1994, Saskatchewan is the only one to impose a further tax increase (\$0.80 per carton).

Figure 7
Tobacco tax (federal and provincial) increases and decreases in Canadian provinces, 1994-1998

Province	Amount of 1994 tax rollback	Post-rollback tax increases, (to Sept. 1/99)	Tax increases (decreases) adjusting for inflation	Percentage of real tax increase since 1994	Year in which nominal taxes return to 1993 levels	Year in which real taxes return to 1993 levels
BC	\$ 5.00	—	(\$2.95)	-7%		
AB	\$ 5.00	—	(\$2.33)	-7%		
SK	\$ 5.00	\$0.80	(\$1.69)	-5%		
MB	\$ 5.00	—	(\$2.49)	-7%		
ON	\$19.20	\$3.20	\$0.95	3%	2032	2179
PQ	\$21.00	\$5.08	\$2.77	9%	2022	2062
NB	\$14.00	\$2.20	(\$0.10)	-.3%	2034	
NS	\$14.00	\$2.60	\$0.30	1%	2024	2578
PE.	\$18.50	\$4.60	\$1.83	5%	2021	2114
NF	\$ 5.00	—	(\$2.84)	-7%		

Sources: See data in Appendix A, Table I.

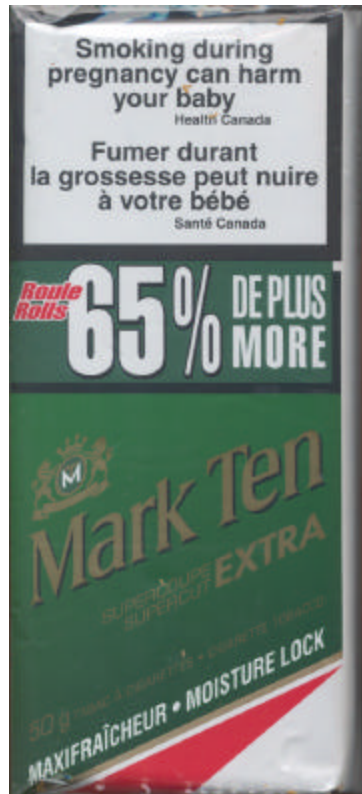
Figure 8
Real change in cigarette taxes since the 1994 tax roll-back.



See data in Appendix A, Table I.

Discount Pricing and Low taxes on “Roll-Your-Own” Cigarettes and “Tobacco Sticks”

Tobacco products are taxed on a per-unit basis, but not all tobacco units are equally priced. Manufactured cigarettes are taxed at much higher rates than are tobacco ‘sticks’ and roll-your-own (“fine cut”).



In the case of roll-your-own tobacco, taxable units are defined in terms of weight. In recent years, tobacco manufacturers have actively marketed new forms of such tobacco that are designed to provide more cigarettes per weight and, consequently, more cigarettes per tax dollar paid. These ‘expanded’ forms of tobacco have reduced the amount of tobacco needed in a roll-your-own cigarette from 1 g/cigarette (in the 1980s) to 0.7 g/cigarette (in the early 1990s) to 0.45 g/cigarette today for at least one brand (Rockport). Because taxes have not been adjusted to respond to the new ‘expanded’ tobaccos, the cost of roll-your-own cigarettes has fallen dramatically.

Tobacco sticks are an innovation developed by tobacco manufacturers simply to exploit tax loopholes. The market share of tobacco sticks has grown steadily: 1.3% in 1994, 2.1% in 1995, 2.6% in 1996, 2.8% in 1997 and 3.8% in 1998.¹⁸ This growth in market share — which has occurred simply because of government failure to close the loophole — has decreased government revenue and impeded health objectives.

In late 1997, Imperial Tobacco began marketing the Player’s Insta-Kit. This product is a fully manufactured cigarette except that it is up to the smoker to place the filter overwrap over the filter. Although some provinces have ruled that this product is a cigarette, Revenue Canada has ruled that the product is a tobacco stick and thus eligible for reduced taxation. Rothmans, Benson & Hedges initially commenced proceedings in the Federal Court of Canada against Revenue Canada to overturn the ruling. After the Court ruled that it was premature to bring the claim to court, Rothmans, Benson & Hedges then

¹⁸Imasco Ltd., 1998 Annual Report, p.25; Imasco Ltd., 1996 Annual Report, p.25.

launched its own competitive product similar to the Player's Insta-Kit, the Rockport Presto-Pak. This loophole exploitation could be ended if the tax rate on tobacco sticks was equalized with the tax rate on cigarettes.

Researcher Josie d'Avernas, Senior Consultant with the Program Training and Consultation Centre in Kitchener, Ontario, has found that teenagers are purchasing Presto Paks:



“Our organization, the Program Training and Consultation Centre, recently completed a series of workshops to train community workers in smoking cessation strategies for teens. Part of each workshop included a panel of local teenagers who smoke, to get a first-hand discussion about what works and what doesn't work to motivate and support teens in smoking cessation.

It concerns me greatly that at each workshop (there were three in total) low prices for tobacco were mentioned by teens as something that makes it hard to get serious about quitting smoking. Agreement was universal that higher prices would be one of the most effective things we could do to motivate smoking cessation.

It was also apparent that teens were aware of the existence of Presto Packs. Indeed, they reported knowing people who bought them, or bought them themselves, because of their lower price as compared to cigarettes.

This is an issue of great concern that I feel compelled to draw to your attention. It is one more gaping hole that the tobacco industry has punched into our tobacco control efforts. If these Presto Packs continue to be priced significantly lower than cigarettes, they are certain to draw a large youth market. This must be stopped.”¹⁹

Figures 9A and 9B show the comparison between tax rates for cigarettes, tobacco sticks and fine-cut units at both the federal and provincial levels. As indicated by the figures, it is really the federal government that is responsible — far more than the provinces — for

¹⁹Josie d'Avernas (Program Training and Consultation Centre), letter to Rob Cunningham (Canadian Cancer Society), February 17, 1999.

the failure to equalize tax rates between cigarettes and tobacco sticks. Adding GST and provincial sales taxes further widens the price gap between these categories of tobacco products.

Figure 9A
Federal Tobacco Taxes on 200 cigarettes/sticks/fine-cut units

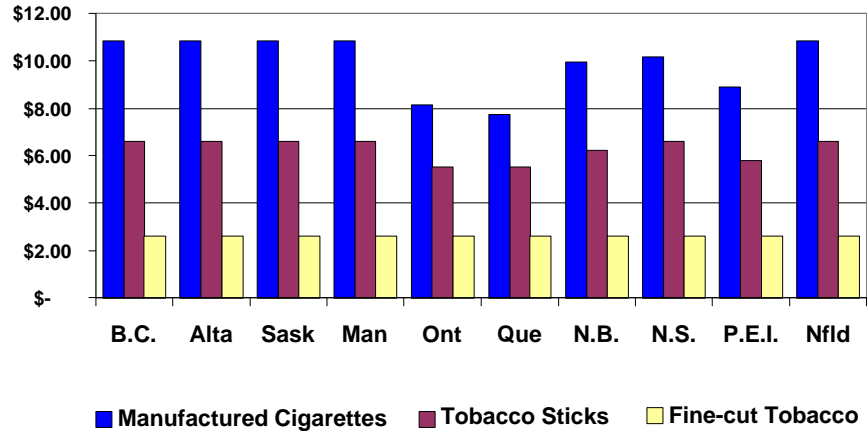
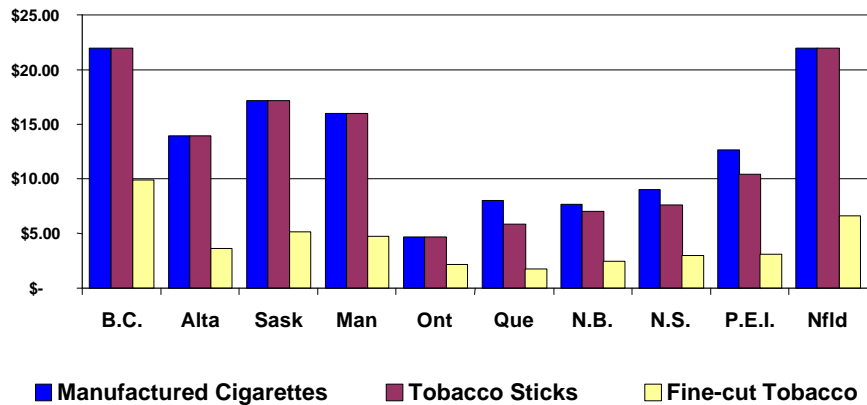


Figure 9B
Provincial Tobacco Taxes on 200 cigarettes/sticks/fine-cut units



Sources: See data in Appendix A, Tables A, B, C.

Manufactured cigarettes vary in price from 15 cents each (in Ontario) to 27 cents each (in Newfoundland). Tobacco sticks range from 12 cents each (in Ontario) to 23 cents each (in Newfoundland). Roll-your-own cigarettes can be made for as little as 6 cents each (in Ontario) to 9 cents each (in British Columbia).

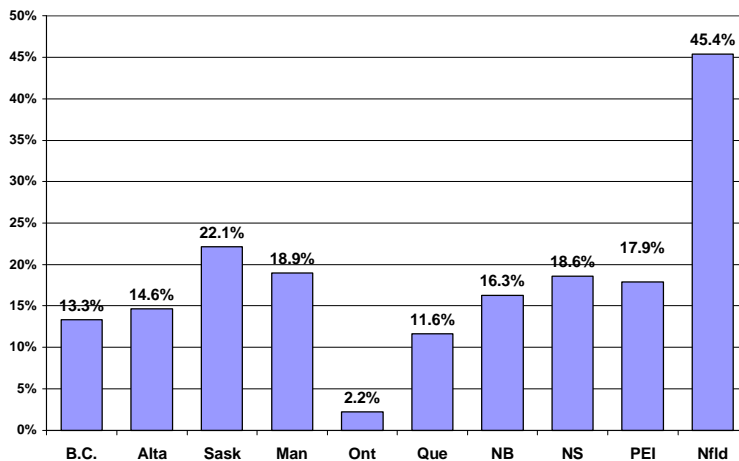
There is no public interest rationale for providing lower tax rates on some forms of tobacco than on others, or for providing any form of ‘cheap’ cigarette. And yet the tobacco tax policies of many governments do exactly this. Availability of lower-priced tobacco products deters quitting and facilitates increased daily consumption.

Fine cut and tobacco sticks make up a considerable portion of the market in many provinces, as indicated in Figure 10. The market share for these cigarette alternatives tends to be greatest where the price differential between cigarettes and fine cut is greatest.

Current tax rates for manufactured cigarettes, tobacco sticks and fine-cut tobacco are provided in Appendix A, Tables A to C.

“U.S. Cigarette Sales continue to fall... With the price of an average pack of cigarettes going from roughly \$1.90 to \$2.70 per pack over the last 18 months, we have anticipated consumption to be down by double digits. In 1993, volume was 460 billion units. We project this could drop to between 410 billion and 420 billion units in 1999.”

Figure 10
Sales of fine-cut tobacco and tobacco sticks as percentage of total tobacco market, by province, 1997



Sources: Wholesale shipment data provided to Health Canada by tobacco manufacturers and released under Access to Information.

John C. Maxwell
“The Maxwell Report USA”,
Tobacco Reporter, May 1999

Canada’s tobacco taxes: in the OECD basement

There is a natural tendency in Canada to compare tax rates with those in the United States. In issues of tobacco taxation, this has had unfortunate consequences, as the tax levels in the U.S. have been among the lowest in the developed world.

The 1998 master settlement agreement between the U.S. State Attorneys General and the U.S. tobacco industry resulted in payments to government which were passed on to smokers in the form of price increases. Strictly speaking, this is not a tax, but has had an equivalent, beneficial health impact by significantly reducing sales of tobacco products.

The court settlement and subsequent price increase have also resulted in cigarettes being more expensive throughout the United States than in Central Canada for the first time in decades, if ever. Canada's cigarette prices and tobacco taxes are much lower than in most other developed countries, as indicated in Table 1.

Table 1
Average Retail Cigarette Price and Total Taxes per Pack (Canadian Dollars/Pack), Selected Countries, April 7th, 1999

Country	Price	Tax	Tax Incidence
United Kingdom	9.75	8.39	86%
Denmark	8.13	6.65	82%
Ireland	8.09	4.85	71%
Sweden	7.84	5.51	70%
Finland	7.46	5.68	76%
United States (Highest – Anchorage, Alaska)	6.92	2.85	41% ²⁰
Canada (Highest - NF)	6.66	4.98	75%
France	5.97	4.51	76%
Germany	5.43	3.84	71%
Belgium	5.28	3.94	75%
Netherlands	4.90	3.52	72%
Austria	4.69	3.47	74%
United States (Lowest – Kentucky)	4.52*	0.51	11% ²¹
Italy	3.86	2.88	73%
Canada (Lowest – ON)	3.79	2.10	55%
Greece	3.59	2.61	73%
Portugal	3.52	2.80	80%
Spain	2.43	1.77	73%

Notes:

All figures given for equivalent of 25-cigarette pack in most popular price category.

Tax incidence refers to the portion of the total retail price made up of applicable taxes and fees, including excise, sales, VAT, etc. Exchange rates as of April 7th, 1999.

Sources: Non-Smokers' Rights Association, European Union, Alaska Dept. of Revenue, Tobacco Institute.

*US prices do not include manufacturers' price increase of August 17th, 1999, equivalent to \$0.41 per pack of 25 at April exchange rate.

²⁰ Many American states, including Alaska, allow municipalities to impose local taxes on tobacco. Note that U.S. prices include approx. 84¢ Canadian per pack to cover the cost of the November 1998 settlement with State Attorneys General. If this sum were considered a tax, total tax incidence in Anchorage would be 53%.

²¹ U.S. prices include approx. 84¢ Canadian per pack to cover the cost of the November 1998 settlement with State Attorneys General. If this sum were considered a tax, total tax incidence in Kentucky would be 30%.

Prices in the United States will continue to rise, increasing the room available for tax increases in Canada. For example, in late August 1999, manufacturers increased their price to wholesalers by 18¢ per pack of 20, for a retail price increase of more than CDN\$ 3.00 per package once sales taxes are factored in. This further widens the gap between Canadian and American cigarette prices.

Recommendations

The federal government should move as quickly as possible to restore cigarette taxes to levels which promote health and prevent disease. Desirably, they should work with the provinces to co-ordinate increased tax levels in all jurisdictions. If there is no immediate agreement with the provinces, the federal government should be prepared to move quickly and unilaterally.

- Cigarette taxes should increase by at least \$10.00 per carton (\$5.00 federal, \$5.00 provincial) in Ontario, Quebec, New Brunswick, Nova Scotia and Prince Edward Island.
- If provinces are unwilling to make a joint increase with the federal government, the federal government should set aside the “gentleman’s agreement” and move quickly to act alone to raise tobacco taxes.
- From a public health perspective, a single, major tobacco tax increase is preferable to a series of small tax increases, since it is more likely to have a significant impact on consumption and youth smoking prevalence.”
- Ontario taxes should be increased by a further \$1.00 per carton (50¢ federal, 50¢ provincial) to remove the current differential between Ontario and Quebec taxes.
- There should also be a federal cigarette tax increase in the four Western provinces, in Newfoundland and the territories of at least \$3.00 per carton.
- In Alberta, there should be an additional provincial increase, given that tobacco taxes are significantly lower than in neighbouring B.C. and Saskatchewan.

“That in the opinion of this House, the government should (a) restore the tax on cigarettes to the level existing at January 1, 1994; (b) increase the rate of tax on tobacco sticks so that the tax rate on tobacco sticks is equal to the tax rate on cigarettes; (c) increase the rate of tax on fine cut tobacco, smokeless tobacco and leaf tobacco intended for retail sale so that the tax on one gram of tobacco is equal to the rate of tax on one cigarette; and (d) improve the tax-paid markings that are required on packages of tobacco products and apply the incremental revenue to health care.”

**Reform M.P. Dr. Keith Martin,
Private Member’s Motion
M337, tabled February 17,
1998.**

Restoring balance

Tax policy should be used to ensure that all forms of cigarettes (manufactured, 'sticks' and roll-your-own) are equally priced, and that benefits to public health resulting from expensive cigarettes are not undermined by cheap alternatives.

- The loopholes allowing lower taxes for tobacco sticks and roll-your-own tobacco should be eliminated.
- The tax rate on a tobacco stick and on the quantity of roll-your-own needed to make a cigarette (now less than 1g) should equal the tax rate on one cigarette.
- Similarly, the loophole for raw leaf tobacco and for smokeless tobacco should be eliminated. The tax on one gram of raw leaf tobacco and on one gram of smokeless tobacco should be equalized with the tax rate on one cigarette, as is the case in Western Canada and Newfoundland.