

NATIONAL
COALITION
AGAINST
CONTRABAND
TOBACCO



LA COALITION
NATIONALE
CONTRE
LE TABAC DE
CONTREBANDE

Stopping the sale of illegal cigarettes in Canada

Enrayer la vente de cigarettes illégales au Canada

National Coalition Against Contraband Tobacco 2018 Pre-Budget Recommendations

About the NCACT

The National Coalition Against Contraband Tobacco (NCACT) is a Canadian advocacy group formed in 2008 with the participation of businesses, organizations and individuals concerned about the growing danger of contraband tobacco. The NCACT's eighteen members share the goals of working together to educate people and urge government to take quick action to stop this growing threat.

The NCACT works to raise awareness amongst all levels of government and the public about contraband tobacco, as well as to encourage meaningful action on this important problem. More information about the coalition can be found on our website, www.stopcontrabandtobacco.ca.

The members of the NCACT are: Association des détaillants en alimentation du Québec (ADA), Association des marchands dépanneurs et épiciers du Québec (AMDEQ), Canadian Chamber of Commerce, Canadian Convenience Stores Association (CCSA), Canadian Manufacturers and Exporters, Canadian Taxpayers Federation, Canadian Tobacco Manufacturers Council, Conseil du patronat du Québec (CPQ), Customs and Immigration Union, Échec au crime Québec, Fédération des chambres de commerce du Québec (FCCQ), Frontier Duty Free Association (FDFA), National Capital Area Crimes Stoppers, National Convenience Stores Distributors Association (NACDA), Ontario Chamber of Commerce, Retail Council of Canada, Toronto Crime Stoppers and United Korean Commerce and Industry Association (UKCIA).

Why Contraband Tobacco

Contraband tobacco is a major problem in Canada. About 1 in 3 cigarettes purchased in Ontario are illegal and Quebec has identified a contraband incidence of about 15%. Police are seizing more and more illicit tobacco products heading into Atlantic Canada and the Prairies.

The contraband trade has developed in Canada because organized crime groups have been able to sell illegal cigarettes for a fraction of the price of legal product. A "baggie" of 200 contraband cigarettes can cost as little as \$8, \$80-100 less than the cost of a carton of legal product. There's also a growing trend of branded, legitimate looking packs of illegal cigarettes. These now represent about 75% of the contraband market in Ontario. While these are unregulated and untested, many Canadians believe them to be legal.

Finance Minister Bill Morneau and the Parliamentary Budget Officer have indicated that even a small difference in price between newly-legal and illegal marijuana will mean consumers won't switch. Canada has seen the evidence of that with tobacco for years.

The Royal Canadian Mounted Police (RCMP) has identified about 175 criminal gangs involved in the trade; producing as many as 10,000 cigarettes a minute in 50 illegal factories operating in Canada. Gangs use the proceeds to fund their other illegal activities, including guns, drugs and human smuggling.

The trade has a meaningful impact on government revenues as well. Obviously, given the nature of underground economies, it is difficult to measure the exact tax loss from the illegal cigarette trade. However, a number of provincial governments and third parties have identified hundreds of millions of dollars in increased revenues from action against contraband tobacco.

Don Drummond's 2012 report on the future of Ontario's finances highlighted how actions such as those suggested below could increase provincial revenues by as much as \$225 million a year¹. In Quebec's last budget, increased enforcement through the Acces Tabac program netted an additional \$180 million in revenues in Quebec alone. In New Brunswick, government sources show that every percentage reduction in contraband tobacco increases the province's revenues by \$1 million. Additionally, the Canadian Taxpayers Federation has estimated that tax loss for the Federal and Provincial governments in Ontario alone is as much as \$1.1 billion a year².

If provinces are losing money to illegal cigarettes, so too is the Federal Government. Effective action against contraband tobacco hurts organized crime, increases the effectiveness of tobacco control regulations, especially those limiting youth access, and increases revenues for the Federal Government and provincial partners.

Anti-Contraband Tobacco Budget Actions

Federal and provincial governments have introduced a number of anti-contraband tobacco measures in recent years. This include the *Tackling Contraband Tobacco Act*, which created criminal penalties for smuggling and new anti-contraband tobacco enforcement units in New Brunswick and Ontario. Ontario has also recently launched a licensing regime for non-tobacco manufacturing materials like cigarette filters.

However, Canada's contraband tobacco problem is entrenched and these measures will not be sufficient on their own to address it. Moreover, the NCACT is concerned that upcoming changes to tobacco packaging regulations proposed in bill S-5 will facilitate an increase in contraband and counterfeit tobacco. So-called "plain packaging" requirements will make it easier for contraband smugglers to create illegal product, and will make it much easier for illegal manufacturers to create counterfeit cigarettes, up to now a limited market.

Even "traditional" contraband tobacco will benefit from plain packaging: illegal cigarettes in Australia spiked following the introduction of plain packaging, and Canada's criminal market is much more entrenched than Australia's was. Indeed, there is some recognition by government

¹ <http://www.fin.gov.on.ca/en/reformcommission/chapters/ch18.html#ch18-a>

² <https://www.taxpayer.com/media/How%20Much%20is%20Contraband%20Tobacco%20Costing%20Taxpayers%20in%20Ontario%20-%20December%202012.pdf>

that branded marijuana will help curb the illegal market. What is true for cannabis is also true for tobacco.

The NCACT has identified six straightforward areas that government can focus on to enhance its efforts on this illegal trade. They are no- or low-cost, recommended by a diverse variety of stakeholder groups, and supported by the public.

Possible anti-contraband tobacco platform items:

1) Expand RCMP anti-contraband enforcement

Anti-contraband tobacco enforcement works. There's no clearer example of this than in Quebec, which has reduced its contraband by half by increasing powers to local police, through Bill 59, and by providing the resources they need to conduct investigations, through the *ACCES Tabac* program.

RCMP anti-contraband enforcement teams, including those in Cornwall, ON and Valleyfield, QC also continue reinforce their value in stopping illegal cigarettes. The Cornwall Regional Task Force can serve as an effective model for such an RCMP taskforce. Quebec has demonstrated that investing in enforcement can pay clear dividends for recouping lost tax revenues from the underground economy, while also providing the social benefits associated with reducing organized crime. Recently, Ontario and New Brunswick have also introduced anti-contraband enforcement units. Bolstering and expanding federal enforcement efforts will pay similar dividends.

As the government moves to legalize recreational marijuana, it will also be important that the federal government not dilute its anti-contraband tobacco enforcement efforts. Having newly contraband marijuana and tobacco enforced with the same resources will not be sufficient.

2) License non-tobacco manufacturing materials, particularly filters and filter components

The 50 illegal cigarette factories in Canada rely on a steady flow of cigarette materials to produce millions of cigarettes a day. Cutting such supplies will hinder or stop their production. By licensing non-tobacco cigarette manufacturing materials, like cigarette filter components, the government can make it more difficult to easily produce the volumes of illegal cigarettes that make their way into Canadian communities.

As the Federal Government moves towards implementing plain packaging regulations in the near future, regulating cigarette filters may be the most effective way in cutting down on the production of illegal tobacco.

Cigarette filters are essential to the manufacturing process and, because of their specialized nature, are not readily replaced. This would include ready-made filters, as well as acetate tow, the substance used in cigarette filters. Acetate tow is produced by only a handful of manufacturers globally, in contrast with actual loose-leaf tobacco which can be sourced from a variety of locations and smuggled into Canada.

There is broad support for increased licensing of acetate tow from a variety of stakeholders, including health groups such as the Canadian Cancer Society, the Ontario Medical Association and the Heart and Stroke Foundation. Even the Global Acetate Manufacturers Association, which represents the largest multinational corporations producing the product, has supported the NCACT's position in regulating acetate tow.

Ontario has begun a licencing regime provincially, but this obviously only affects that province. This is a national problem that merits national attention.

3) Audit the Federal Tobacco Tax Stamp System

Presently, federal tobacco excise stamps appear on products that are clearly contraband. These stamps were designed with the goal to more easily detect and respond to counterfeit and illicit tobacco products. However, by appearing on cigarettes that do not meet the labelling, packaging and information requirements in the Tobacco Act they actively undermine awareness and clarity among consumers³. Even when on "legal" products, the current stamps can confuse consumers who may think that products with a federal "peach" stamp have all taxes paid, when they do not. Canadians will be rightly confused if they receive a hefty fine for tax avoidance for possessing a package that says "Canada Duty Paid" on it.

The fact that federal stamps are appearing on illegal products that do not meet Health Canada standards suggests that the current system is flawed. The NCACT recommends that the government audit the federal stamps system in order to ensure there is clarity on legal vs. illegal products. This will provide greater awareness to the consumer in regards to providing reliable information on whether tobacco products are meeting all federal guidelines.

4) Increase intergovernmental cooperation on efforts to combat contraband tobacco by leading a National Anti-Contraband Taskforce.

Contraband tobacco is a problem that crosses jurisdictional and departmental boundaries. Effective actions to address this problem will be built on collaboration between the federal and provincial governments, state and U.S. governments, private sector and First Nations leaders.

Learning from provinces that have had success in addressing the contraband problem is critical. As an example, Quebec has significantly reduced the volume of illegal tobacco in the province through effective coordination and increased enforcement efforts, which could serve as a model for other affected areas of Canada. Ontario, for its part, is pursuing revenue-sharing pilot projects with two First Nations territories. We are encouraged by the initiatives undertaken in both jurisdictions.

The Federal Government should play a leadership role to play in this collaboration. This should include appointing and leading a task force of interested parties, including those listed above, to share best practices and to explore alternative solutions, including revenue-sharing.

³See, for example: <http://www.torontosun.com/2016/01/16/the-sleeping-dog-of-contraband-cigarettes>

5) Implement a public awareness campaign regarding the risks of contraband tobacco

It is our experience that many Canadians are unaware of the dangers that illegal cigarettes offer and, in many cases, what actually constitutes contraband tobacco. Beyond confusion over tobacco tax stamps, there is a growing trend for wholly untaxed tobacco products to look like legal, regulated product. Research in Ontario suggests that only 1 in 3 smokers believe that cigarettes purchased at unlicensed smoke shacks are illegal.

Most Canadians will not willingly break the law. Given that there is an increase in offences for transport and possession of untaxed tobacco products, government should educate the public about how to correctly identify legitimate products, as well as the risks associated with using illegal ones. Any cost should be easily offset by corresponding reductions in tax diversion to the criminal market.

This is made even more important with the Federal Government's proposed plain packaging regulations, which has the potential of creating a counterfeit tobacco market, which up until now is a limited market. An increase in counterfeit product will make it more difficult for consumers to properly identify legal products versus illegal products.

6) Keep the Cornwall border crossing in Cornwall

A substantial portion of illegal cigarette manufacturing takes place near Cornwall, Ontario in territories that straddle the Quebec, Ontario, and American borders. There are more than a dozen illegal cigarette factories operating in the territory, making the area a major source of illegal cigarettes in Canada.

At present, the border crossing is located in Cornwall, Ontario, on the Ontario side of Cornwall Island. This crossing's current location was established "temporarily" in 2009, but produced a near-immediate and demonstrable improvement in stopping contraband tobacco smuggling at this crossing.

The government has previously proposed to move this crossing to Massena, NY as part of a larger effort to consolidate crossings. Cornwall, however, is an exception with a unique set of local circumstances that merit a different response. The crossing should remain where it is.

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