The following is an excerpt on taxation and smuggling from an OCAT document (February 2003) entitled, ***Tobacco Control: Myths and Realities***.

TAXATION AND SMUGGLING

Further increases in Ontario tobacco taxes beyond increases in the June 2002 budget will lead to renewed smuggling. (Source: Hon. Janet Ecker, various media, Opposition and Government members).

Comment: Of all the misinformation and inaccuracies pervading the tobacco control debate, the persistent belief that tax increases inevitably lead to smuggling, and that they will produce this result in Ontario and Quebec under current circumstances, are the most persistent.

To begin with, the direct role of the tobacco industry in promoting and facilitating smuggling in 1992-4 is not well-known. In the case of cross-border smuggling between Ontario, Quebec and New York state in 1992-4, legal proceedings, investigations by the CBC and the Montreal Gazette, and tobacco industry documents, have all shown that the industry was directly complicit in smuggling during this period. In the words of the Honourable André Denis of the Quebec Superior Court in his December 13, 2002 decision in JTI-Macdonald v. Canada: “the industry was a willing accomplice of black-market cigarette smugglers.”

A 1993 cigarette company document shows Imperial Tobacco’s current Chairman, Don Brown, asking his British head office not to charge Imperial a royalty on export sales to the US during this period, as he knew they would be coming back into Canada as contraband.
In other words, Canadian manufacturers were predicating their business plans on the promotion and facilitation of smuggling during this period.

Two other factors further contributed to the smuggling crisis of 1992-4. **One was the elimination by the federal government of an export tax previously placed on all cigarettes manufactured in Canada at the factory gate.** In other words, it was possible at this time for completely tax-free cigarettes to be made available for export.

The second major factor was the relative ineffectiveness of law enforcement between the US, Ontario and Quebec. Coordination between US and Canadian police, customs and excise officials was poor or nonexistent, and insufficient personnel were dedicated to policing this problem. Compounding this difficulty was the fact that a First Nations reserve straddled the US-Canada border, leading to limitations in the ability of provincial and federal law enforcement personnel to intervene on this property.

Finally, differences in the price of cigarettes in Ontario, Quebec and New York State (Canadian prices were routinely $15-20/carton higher than in New York State in the early 1990s) meant that export of Canadian tax-free cigarettes to New York State would not result in the need to pay New York State taxes over and above those imposed in Canada.

Today, this situation is completely different for a number of reasons:

- In light of the available evidence about Canadian tobacco companies’ complicity in the 1992-4 smuggling crisis, the RCMP and other government agencies have been investigating the extent of the companies’ roles, with a view to possible criminal charges. The Canadian government sued RJR-Macdonald under the *Racketeer Influenced and Corrupt Organizations Act* in the United States to recover revenue lost due to the company’s participation in the smuggling crisis. While this suit did not succeed owing to a technicality unrelated to the evidence, the federal Solicitor General has announced he is considering relaunching the same suit in a Canadian court, and possibly extending it to all three Canadian tobacco companies. It is hard to imagine how the companies could renew any complicity in smuggling under this scrutiny.

- In the April 2001 budget, the federal government imposed a two-tier export tax on <u>all</u> Canadian tobacco products leaving Canada. A $10/carton rate applies to exports up to 1.5% of a tobacco manufacturer's annual production. This amount is refundable upon proof of payment of taxes in a foreign jurisdiction to which Canadian product is destined. An additional $22/carton tax is applied on exports that exceed the 1.5% threshold. Exports exceeding the 1.5% threshold are therefore subject to a $32/carton price increase, effectively removing any incentive to illegally re-import product into Ontario or Quebec.

  Also in the April 2001 federal budget, additional taxes on Canadian tobacco delivered to duty-free shops in Canada and abroad, as well as on tobacco products sold as ships' stores, and a tax on imported tobacco products delivered to Canadian duty-free shops, closed off the attractiveness of duty-free products.

- Since the 1992-4 smuggling crisis, special task forces and other cooperative agreements were set up between US and Canadian border law enforcement personnel. Border security has been even further tightened following the events of 9/11.

- Tracking and tracing technology is now available to help deal with smuggling. Through the use of special package markings, which are very difficult, if not impossible, to counterfeit, the origin and routing of tobacco products can be precisely tracked to help ensure they are being marketed through legal channels.

- Finally, the price differential between New York State and Ontario and Quebec has completely reversed since the 1990s. Today, the average price of a carton of 200 cigarettes in New York State is Cdn$76.31, as compared to the $54-55/carton average in Ontario and Quebec.

A current variation on the threat of renewed smuggling is the claim by tobacco companies and retailers in Quebec that sales of contraband cigarettes have resumed, and that smuggling is being reignited in part due to First Nations and off-shore production of "counterfeit" Canadian cigarettes.

While it is true that there is some production of "counterfeit" Canadian cigarettes on First Nations reserves, which are not subject to federal and provincial excise taxes, the size of production facilities are nowhere near enough to create any significant market for these products.

Furthermore, without the industry's complicity in smuggling (which is impossible today for the reasons described above), it would be physically impossible for First Nations reserves (or any other smugglers) to supply even a small fraction of the same amount of contraband supplied in 1992-4.

For example, in 1993 the Canadian tobacco industry "exported" between 13 and 20 billion cigarettes that were subsequently found on the Canadian black market, primarily in Quebec and Ontario. If an average smuggler's speedboat contains an average of 10 cases of 10,000 cigarettes, it would take 100,000 trips, or 300 trips per night for 300 nights, to supply less than 10 billion cigarettes.

This is not counting the loading and unloading of trucks, transportation of cargo to points of sale, and other logistics, all of which would be occurring under the surveillance of the newly consolidated law enforcement teams made up of Canadian and American police, customs and excise personnel. From a purely practical point-of-view, therefore, any resurgence of the early 1990s smuggling problem between Canada and the US is impossible.