



**Submission on Bill C-69,
*Budget Implementation Act, 2024, No. 1***

May 22, 2024

Executive Summary

Imperial Tobacco Canada (ITCAN) welcomes the opportunity to comment on Bill C-69, *Budget Implementation Act, 2024, No. 1*. Our feedback is focused on the provisions dealing with tobacco and vaping product tax increases in Division 2 of Part 3, and the proposed amendments to the *Food and Drugs Act* spelled out in Division 31 of Part 4.

The proposed tobacco tax increase in the 2024 budget seems to overlook the significant issues related to illegal tobacco in Canada. Illicit tobacco, accounting for over one-third of the market, deprives the federal and provincial governments of approximately \$2.5 billion in annual tax revenue, profiting more than 175 organized crime groups across Canada involved in this illegal trade.

The decision by the Federal Government to implement another increase in tobacco taxes, without taking steps to combat the illicit trade, appears negligent, especially as various provinces have recently introduced measures to tackle this issue. This approach could potentially undermine these provincial efforts. Furthermore, it seems the Finance Minister is not recognizing that addressing illegal tobacco will yield greater financial and societal benefits than increasing the tobacco tax.

The decision to raise the vaping tax is notable, particularly because the federal-provincial harmonized vaping tax is set to be implemented in Ontario, Quebec, Northwest Territories, and Nunavut on July 1, 2024. This might be an unprecedented move by the Federal Government, as it would be the first instance of a tax being increased before it has even been implemented.

More significantly, the tax increase will further skew the market towards illicit products. Furthermore, addressing the market-distorting aspects of the current tax structure would generate more revenue than the proposed increase in the vaping tax.

Meanwhile, the proposed amendments to the *Food and Drugs Act* seem to be the method the Health Minister is using to address his concerns regarding ITCAN's ZONNIC nicotine pouches, the first and only such product approved as a Nicotine Replacement Therapy (NRT) in Canada. While reform of the regulatory framework for NRTs is necessary, the approach of the Health Minister, which seems to focus on a single NRT product from one company and is based on gross misinformation, raises concerns.

The proposed amendments grant the Health Minister extensive regulatory power over all natural health products, bypassing the established approval process and placing the fate of these products under the discretion of the current Minister, future Ministers, and Health Canada. We recommend the complete removal of Section 326 from the Bill to prevent this regulatory overreach. Instead, we suggest developing a new, equitable regulatory framework for all NRTs.

About ITCAN

ITCAN, established in 1908, is a wholly owned subsidiary of BAT – the world’s largest vaping business by market share. ITCAN has made significant investments in scientific research and development to introduce a ‘Reduced Risk Products’ portfolio,¹ which includes vaping and cessation products.

ITCAN is dedicated to conducting its business responsibly, in a manner that meets society’s expectations of a responsible tobacco and nicotine products company. ITCAN recognizes the health risks associated with tobacco and nicotine consumption and believes that youth under the legal minimum age (“Underage Youth”) should not consume and should be prevented from accessing tobacco or nicotine products.

We support constitutional, proportional, reasonable, and evidence-based regulation, especially measures aimed at keeping tobacco and vaping products out of the hands of Underage Youth. At the same time, we are committed to contributing to tobacco harm reduction and ensuring that adult consumers are provided with a range of less risky alternatives to combustible cigarettes.

Context for Bill C-69

ITCAN welcomes the opportunity to comment on Bill C-69, *Budget Implementation Act, 2024, No. 1*. This comes at an interesting historic moment for ITCAN. We are in the process of an organizational transformation in which at its core lies our ambition to reduce the health impact of our business. A critical enabler to achieving this will be to encourage smokers to quit or switch to ‘Reduced Risk Products’ – like vaping products.

We acknowledge the Government’s goal of reducing the smoking rate to 5% by 2035 and feel Reduced Risk Products must be central to achieving that. As such, the regulatory and taxation regime for vaping products is of critical importance to ensure they remain appealing and affordable alternatives for adult smokers.

Meanwhile, in October 2023 we launched ZONNIC, the first nicotine pouch authorized for sale by Health Canada as a Nicotine Replacement Therapy (NRT). It provides consumers who want to quit smoking and using nicotine a new way to do so. ZONNIC nicotine pouches underwent extensive efficacy and safety review by Health Canada over two years and were granted a natural health product license in July 2023.² ZONNIC nicotine pouches do not contain tobacco, do not produce tar or carbon monoxide, and therefore do not present the same risks as cigarette smoke. A nicotine pouch works in a very similar way to NRT gum or lozenges. It helps smokers quit by delivering nicotine to the body, temporarily relieving cravings and nicotine withdrawal symptoms.

¹ We use the term ‘Reduced Risk Products’ (or RRP) to cover tobacco and nicotine products that are reduced risk compared to cigarettes based on the weight of evidence and assuming a complete switch from cigarette smoking. These products are not risk free and are addictive.

² <https://health-products.canada.ca/lnhpd-bdpsnh/info?licence=80125630>

Providing adult smokers with less risky alternatives and NRTs will continue to be our ambition, driving all our business decisions in Canada. However, we must still acknowledge around 11% of Canadians continue to smoke, and the key question should be whether the Government would prefer those people purchase cigarettes through a legal, regulated and taxed market, or an illegal, unregulated and untaxed free-for-all.

Canada's Illegal Tobacco Reality

Canada has an immense illegal tobacco problem. At the national level, we estimate illegal tobacco makes up over one-third of the market, and this rate has been growing in recent years. For the Finance Minister to raise tobacco taxes by \$4/carton in the April 16 budget – just 16 days after a legislated tobacco tax increase of \$1.49/carton per an inflation-based formula – suggests the Government might not be fully informed about the complexities of Canada's illegal tobacco realities and continues a trend of federal decisions that have been great for the illegal operators, including:

- \$4/carton tobacco tax increases in 2021 and 2024 outside the legislated framework that provides for inflation-based increases on April 1 of each year, making cheaper illegal products more appealing for cost-conscious consumers;
- Banning menthol cigarettes, which gave the illegal operators a monopoly on that product;
- Plain and standardized tobacco packaging and standardization of cigarettes themselves, making it virtually impossible for consumers, retailers and law enforcement to tell a legal from an illegal product; and
- Repealing mandatory minimum sentences for repeat illegal tobacco offenders.

Given all the above, it is not hard to see why illegal tobacco in Canada is thriving.

Seeking to validate internal data that suggested a surge in illegal tobacco activity in late-2021 and through 2022, ITCAN engaged Abacus Data to conduct an independent market assessment of Alberta, British Columbia and Ontario. Abacus Data measured the illegal tobacco rate in Alberta at 36%, in BC at 34%, and in Ontario at 33%. For Alberta and BC, these are the highest rates we have ever seen. The Abacus Data assessments were based on research conducted in the second half of 2022.

Further evidence of the national nature of this problem came in September 2023 with the release of a report to the Convenience Industry Council of Canada by EY Canada. It estimates the illegal market share in BC to be at least 32% and as high as 45%; in Ontario to be at least 39% and as high as 69%; and in Newfoundland and Labrador to be at least 31% and as high as 44%.³ EY Canada used a different methodology to assess the illegal market share than Abacus Data, but reached similarly alarming conclusions on the size of the illegal market in 2022.

³ <https://convenienceindustry.ca/wp-content/uploads/2023/09/EY-Report-on-Contraband-Tobacco-in-BC-Ontario-and-Nfld-September-2023.-FINAL.pdf>

Illegal tobacco is costing the federal and provincial governments \$2.5 billion in lost tobacco tax revenue annually.⁴ Meanwhile, the organized crime groups behind Canada's illegal tobacco trade continue to use it as a cash cow to fund other criminal activities, including drug and weapons trafficking, human smuggling, money laundering and terrorist financing.⁵

While the budget suggests the tobacco tax increase will generate \$1.36 billion in new revenue over five years, or \$272 million annually, eliminating the illegal trade would generate upwards of \$1 billion annually⁶ – or more than five times the amount projected from the increase. The provinces seem to recognize this, as eight of ten provinces did not raise tobacco taxes in 2024. Moreover, Alberta, Manitoba, Ontario and Saskatchewan all announced new measures to fight illegal tobacco. These measures and investments will now be undermined by the federal tax increase.

When contemplating new taxes or regulatory measures for the legal tobacco industry, it is crucial to factor in Canada's illegal tobacco reality. Regrettably, the tobacco tax increase in the 2024 budget seems to overlook this context. This trend of increasing taxes on the legal industry is not sustainable. Canada could easily end up with an illegal tobacco rate of 50% or more. If you think that is exaggerated, consider that parts of Northern Ontario are already estimated to have an illegal tobacco rate as high as 70%.⁷

Recommendation: In future years, the Government must respect the legislated formula for annual inflation-based tobacco tax adjustments on April 1 and avoid additional increases that contribute to Canada's growing illegal tobacco trade.

Recommendation: Recognize there is more revenue to be generated from reducing illegal tobacco than raising tobacco taxes and launch a Committee study to investigate long-term solutions to this persistent problem.

Vaping Tax Structure

The 2024 budget announced the federal vaping tax will rise by 12% effective July 1, 2024. The federal tax originally took effect on October 1, 2022, and the Federal Government said it would invite provinces and territories to harmonize. The first four – Ontario, Quebec, Northwest Territories and Nunavut – will do so on July 1, 2024. This means that the Federal Government is increasing the harmonized tax *before it is even implemented*. That is unprecedented.

However, it is particularly disappointing that the necessary reforms to the federal vaping tax structure have not been addressed. If the government intended to adjust the rate and amend the legislation, as seen in Bill C-69, it should have considered the structural changes we have

⁴ Estimate based illegal market share versus Federal and Provincial Tobacco Tax revenues as detailed in Public Accounts.

⁵ See <https://www.opp.ca/index.php?id=115&lng=en&entryid=590a25088f94ac74657b23c6>, and <https://2009-2017.state.gov/documents/organization/250513.pdf>

⁶ Based on an estimate of 40% of the \$2.5 billion in annual lost revenue being federal.

⁷ <https://kenoraonline.com/articles/new-policing-powers-sought-to-fight-illegal-cigarette-trade>

recommended since the tax was introduced. It is quite likely these structural changes could generate more revenue than the tax increase proposed in the budget.

This is because the tax rate differs based on volume. For provinces and territories that harmonize, the current rate is: \$2.00/2 milliliters of vaping liquid or fraction thereof for containers with less than 10 milliliters of liquid, and for containers with more, \$10 for the first 10 milliliters and \$2 for every additional 10 milliliters or fraction thereof.⁸ These amounts will increase come July 1, but the structural impact does not. Likewise, the structural impact applies for non-harmonized provinces and territories as well.

Therefore, it is clear this structure disproportionately influences the market by promoting the purchase of large volume vaping products over smaller-volume vaping pods. For example, before the July 1 tax increase takes effect, a two-pack of our 1.9 milliliter pods will have a harmonized tax of \$4. Meanwhile, a 20-milliliter bottle of vaping liquid would only have a tax of \$6, despite having five times the volume.

However, in announcing this framework in the 2022 budget, the Federal Government did not offer a justification for discounting larger volume purchases. As a result, this would seem to violate the principle of tax neutrality, in which a tax structure is not designed to favour one sort of product over another, as noted in analysis conducted by EY Canada:

“This rate structure continues to discriminate against closed systems sold at convenience stores compared to open systems sold in vaping shops by placing a much higher federal tax burden on them. There may be a policy reason or objective for this discrimination, but if so, it is not obvious and is not stated transparently in the budget documents. This effective ‘volume discount’ in the tax actually encourages large volume purchases of vaping liquid and that could in turn have the perverse effect of leading to more vaping consumption, not less.”⁹

There is evidence of this market distorting impact. Since this framework was put in place in October 2022, the vaping product market has changed at a rapid pace, primarily with changes to the types of products consumers are purchasing. ITCAN estimates that roughly 50% of the disposable vaping devices sold in specialty vape stores now have a volume greater than 10 millilitres, up from just 1% in September 2022.¹⁰

This shift towards large format disposable vaping products creates a disproportionate market advantage for some producers over others. In addition, the migration of consumers towards large-format vaping products will generate lower than anticipated government revenues. As detailed on the chart below, we estimate the Federal Government is currently losing \$108 million

⁸ Rates shown are those under the federal harmonized framework.

⁹ The Federal Government’s Proposed Excise Duty Framework on Vaping Products: A Commentary with Recommendations, EY Canada, May 9, 2022

¹⁰ For the purpose of these estimates, ITCAN has assumed that all disposable vaping devices stating they contain 6,000 puffs or above have volume of vaping substance greater than 10 milliliters.

annually because of the discounted tax on larger volumes of liquid created by the lower tax rate for volumes over 10 milliliters.

Potential excise collection if 10 ml threshold removed	Excise - VPT	Excise - VAT	Total
Open system products	\$ 83,015,313	\$ 8,301,531	\$ 91,316,845
Disposable products	\$ 13,698,634	\$ 1,369,863	\$ 15,068,498
Closed system products	\$ 1,474,597	\$ 147,460	\$ 1,622,056
Total	\$ 98,188,544	\$ 9,818,854	\$ 108,007,398

Therefore, ITCAN proposes that the current excise advantage for volumes over 10 milliliters be eliminated. This change is better adapted to the rapidly changing behaviours of Canadian vaping product consumers, while removing the fiscal advantage for producers of large-format vaping products.

Alternatively, the Government could limit the volume of liquid in vaping products and vaping liquid refill containers, as well as the capacity of open system vaping devices, to 10 milliliters. This would align with the limit set in the Directive 2014/40/EU1 ('Tobacco Products Directive' or 'TPD') for dedicated refill containers. It would also better reflect the relatively higher risks associated with open system vaping devices and refill containers, including risks associated with the potentially higher metal emissions caused by their heating systems. Furthermore, this change would reduce administrative complexity of the vaping excise regime.

Per the chart above, eliminating the tax advantage for vaping liquids over 10 milliliters in volume would generate more revenue than the tax increase proposed in the budget. The budget suggests the tax increase will generate new revenue of \$310 million over five years,¹¹ or an average of \$62 million annually. Compare that to the \$108 million that could be generated annually by adjusting the tax structure and this is clearly a missed opportunity.

Recommendation: Cancel the vaping tax increase scheduled for July 1, 2024, and instead adjust the vaping tax structure to eliminate the tax advantage for large-format devices.

Finally, the Government must alert itself to the growing market for illicit vaping products in Canada in illicit smoke shacks in Ontario, BC, and Quebec, and vape shops and online retailers across Canada not respecting provincial or federal regulations related to product standards, packaging, or marketing not appealing to youth. Due to a lack of regulatory enforcement, Canada is becoming one of the least controlled vaping product markets in the world.

¹¹ <https://budget.canada.ca/2024/home-accueil-en.html#pdf>

Finally, with the Health Minister reportedly set to impose restrictions on flavored vaping products,¹² the anticipated revenue from the vaping tax may not materialize. Since Quebec banned flavoured vaping products on October 1, 2023, legal sales declined by 50% and we estimate 90% of the vaping products sold in that Province are illegal.

A New Regulatory Framework for NRTs

Division 31 of Part 4 of Bill C-69 suggests amendments to the *Food and Drugs Act*, granting the Minister of Health considerable new powers to issue orders concerning natural health products. This bypasses the usual regulatory approval process. Under Bill C-69, the Minister has the authority to intervene if the use of a therapeutic product, beyond its intended purpose, is believed to pose a health risk. In such cases, the Minister can establish regulations regarding the import, sale, advertising, manufacturing, preparation, preservation, packaging, labeling, storage, or testing of the product to manage or control health risks.

In addition, “the Minister may, in the order, establish rules for the purpose of preventing the therapeutic product from being promoted for a use, other than the intended use, of a therapeutic product or preventing a use, other than the intended use, of a therapeutic product from being appealing.” Also, the Minister “may make the order despite any uncertainty respecting the risk of injury to health that the use of the therapeutic product, other than the intended use, may present.”

In an April 29 media scrum, Minister Holland suggested this power will be used to address nicotine replacement therapy (NRT) products in the form of nicotine pouches. However, the Committee should be aware that the proposed changes to the *Food and Drugs Act* will give the Minister, Health Canada and any future Minister the power to go after any natural health product that he/she/they dislike.

This raises questions about why this specific vehicle is being employed to target NRT nicotine pouches. It seems plausible the law could not be amended in a way that would grant Minister Holland the authority to regulate our NRT nicotine pouch product without similarly affecting other NRT products like gums, lozenges, and sprays. This appears to be part of a continuing trend where Minister Holland disproportionately focuses on our NRT product, overlooking others. It appears the Minister's push for broad new regulatory powers is driven more by personal motives and a grudge against the tobacco industry, rather than by public health objectives.

As noted earlier, in October 2023 ITCAN launched the first nicotine pouch product (ZONNIC) approved as an NRT by Health Canada.¹³ It remains the only such product approved in Canada. ZONNIC nicotine pouches underwent an extensive two-year efficacy and safety review by Health Canada before being approved.

¹² Draft regulations proposed to limited flavours to tobacco, mint and menthol.

¹³ <https://health-products.canada.ca/lnhpd-bdpsnh/info?licence=80125630>

Minister Holland has claimed ITCAN exploited a loophole to secure approval of ZONNIC as an NRT under the *Food and Drugs Act*. This is clearly untrue. We sought and secured approval for ZONNIC nicotine pouches in the same manner as any other NRT product. We followed Health Canada's legislative and regulatory process. That is not exploiting a loophole; it is following the law – and ZONNIC is the only nicotine pouch product in Canada that has done so.

In addition, while Minister Holland focuses on the three flavors of ZONNIC nicotine pouches available in Canada, it is worth noting these flavors were approved by Health Canada during the licensing process. Furthermore, our flavours are consistent with others in the NRT space, as is their naming. For example, Nicorette gum is listed in the following flavours on its Canadian website: extreme chill mint, ultra fresh mint, spearmint, fresh fruit, and cinnamon.¹⁴

Minister Holland has criticized our company for the use of colors in our packaging and our marketing approaches. However, it is important to note our packaging aligns with that of other NRT products and was reviewed by Health Canada during the approval process. Similarly, our marketing strategies, which are in line with industry standards, were fully disclosed to Health Canada as part of the approval process.

Finally, Minister Holland has suggested there is widespread youth addiction to pouches with resultant negative health effects. We have not seen any literature in this regard and the Minister has only offered anecdotes to support this claim. However, even if this is true – and there is no evidence from markets that have had similar products for years of the types of health effects the Minister has suggested – we are confident in saying it is not due to our product for four reasons:

- ZONNIC nicotine pouches were only introduced in Canada through a very limited number of retailers in October 2023 and in very limited volumes until February of this year.
- ZONNIC nicotine pouches are the only licensed NRT products in Canada that are currently stored behind the counter in convenience stores with retailers requiring age verification. We implemented age verification voluntarily; there are no minimum age requirements for the purchase of a natural health product (including an NRT) set out in the *Food and Drugs Act*, the *Natural Health Product Regulations*, or in any provincial legislation.
- In retail locations such as grocery stores, convenience stores and gas stations, our ZONNIC product ordering terms and conditions on our retail product ordering platform require that retailers age verify consumers are 18 years of age or older and that the product be stored behind the counter. If retailers are caught in default of such terms, we will block their ability to order this product.
- On ZONNIC's e-commerce website, we require that consumers confirm they are 18 years of age or older before entering the website, and robust age verification is performed at purchase and at delivery of the product.

If there is youth use of nicotine pouches, we encourage the Government to look at the illegal market. We recently submitted 20 pages of data to Health Canada providing websites of vendors selling illicit pouch products to Canadian consumers. We are also aware of retailers selling illicit

¹⁴ <https://www.nicorette.ca/products/gum>

nicotine pouches in plain sight. This was occurring long before Health Canada authorized the sale of ZONNIC nicotine pouches.

This is why the provisions amending the *Food and Drugs Act* in Bill C-69 should alarm all Parliamentarians. It is a toolkit to circumvent the regulatory approval process for natural health products. No one has challenged the efficacy of ZONNIC nicotine pouches as an NRT; no evidence has been presented of youth use; no evidence of health harm has been presented; and no one has suggested we have done anything in violation of our natural health product license. In fact, we continue to go well beyond what is legally required with regards to protecting against youth access by forcing retailers to ask for proof of age before sale, amongst other things.

However, Bill C-69 gives the Health Minister the power to go after this product despite all the above and without even needing to prove harm or risk – and this power can be used in the future to target any other natural health product that the Minister or Health Canada does not like. Why even have an approval process for natural health products if the Minister can overrule it by decree? It opens up the regulatory process to bias based on the personal beliefs of the Minister, as opposed to an impartial science-based determination of what benefits the health of Canadians.

Recommendation: Remove Section 326 of Part 4 and instead launch a proper consultation on a new regulatory framework for all NRTs.

Our comments above should not be interpreted as suggesting no new rules are required for NRTs. In fact, we have been recommending a new regulatory framework since we launched ZONNIC nicotine pouches, and we continue to be the only provider of NRTs in Canada that self-regulates on things like age-gating and keeping products behind the counter at retail.

We believe a new regulatory framework for all NRTs should include the following:

1. Legal age of 18 to purchase NRT products.
2. Storage and display of products at retail in a way that makes them inaccessible to minors, such as behind the counter in all retail locations.
3. Requiring proof of age at the time of purchase.
4. Age verification for purchase and delivery for online sales.
5. Labelling requirements to prominently inform consumers the product is for adults only.
6. Severe penalties for those who sell or provide these products to youth.

Finally, Minister Holland and all Parliamentarians need to recognize that we have unique insights into the remaining 11% of adult Canadians who still smoke, for whom regulatory interventions and existing NRTs have proven ineffective. Consider that Quebec's National Institute of Public Health recently released a study that found over 95% of current and former smokers are aware of NRTs like nicotine patches, gums and lozenges, but fewer than 10% use them.¹⁵

¹⁵ <https://montreal.citynews.ca/2024/02/23/quebec-smokers-aware-tools-help-quit-dont-use-them/#:~:text=Research%20shows%20that%20although%20many,known%20services%20are%20rarely%20used.>

ZONNIC nicotine pouches give them a new option. That should be welcomed by Minister Holland and the public health community, not challenged. And if the Minister and his former colleagues in the public health lobby cannot focus on the effectiveness of an NRT product rather than who is distributing it, then they really need to take a step back and examine their motives.

We have a shared goal of reducing Canada's smoking rate to the target of less than 5% by 2035, but convincing the remaining 11% of Canadians who smoke to switch to reduced risk products or to quit will be the toughest challenge yet. However, we can contribute to that. Huge numbers of Canadians have already switched from smoking to vaping; that is a positive development. We have also received overwhelmingly positive feedback from smokers about ZONNIC nicotine pouches, with many saying it is the first product to successfully get them off cigarettes. This context makes the approach taken in Bill C-69 to single out this product appear more misguided.

Conclusion

The 2024 budget includes a \$4/carton increase in the tobacco tax, marking the second instance where Minister Freeland has introduced an additional increase beyond the annual inflation-tied adjustment scheduled for April 1. This decision appears to overlook the challenges posed by illegal tobacco operations in Canada, which not only represent a significant organized crime issue but also a missed opportunity for revenue enhancement by curbing these activities.

Meanwhile, the rise in vaping taxes represents a missed opportunity to reform the tax structure to mitigate its market-distorting effects. A more strategic restructuring could have yielded significantly higher revenue gains than those anticipated from the current tax increase. Also, caution is advised when projecting future vaping tax revenues given the expanding illicit market for vaping products. This concern is heightened by potential federal restrictions on flavors, which, based on recent developments in Quebec, could severely diminish the legal market for vaping products without adequate enforcement. The lack of enforcement in Quebec had led to an illegal market share of around 90%.

Also, Parliamentarians should be alarmed at the power grab launched by Minister Holland through the amendments to the *Food and Drugs Act*, which give the Minister the ability to target any natural health product he chooses, without any requirement to justify his action. For now his target appears to be NRT nicotine pouches, but in the future it could be any other natural health product. The powers suggested in Bill C-69 would grant unprecedented control over an extensive portfolio of product categories to any current or future Minister, circumventing the regulatory approval process meant to ensure the best health outcomes for all Canadians.

At its core, Minister Holland's strong opposition to NRT nicotine pouches seems to be driven more by personal feelings than by an acknowledgment of the public health benefits that new NRT products could offer in helping smokers quit cigarettes. There is indeed a need for a new regulatory framework for all NRTs, but it should be established through an open, fair, and transparent process, rather than by a ministerial decree that targets a specific product or company.