



BRITISH-AMERICAN TOBACCO COMPANY LIMITED

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TO: BATCo Board, General Managers, Regional Finance Controllers,
Heads of Department

SUBJECT: Canada - Cigarette Smuggling and Tobacco Taxes

It is four months since the Canadian Government announced a substantial reduction in Federal excise taxes in an effort to eliminate smuggling of cigarettes into Canada from USA. Further to my note of 14 February, I can now advise some more information and consequences of this action.

Indirect taxes on tobacco products in Canada escalated enormously in the late 1980's and early 1990's, e.g. taxes rose in the period 1981-1991 by 575% and Federal and Provincial Governments collect more than C\$ 7 billion per annum. However, the Quebec Government for example collects less money than it did in 1988 as so many smokers were purchasing smuggled cigarettes.

The highest incidence of smuggling from USA is into the provinces of Quebec and Ontario through Indian reservations straddling the border. This illegal trade had built up into a major, organised and highly profitable business, it was also provoking other criminal activity. It was estimated that about 2 million Canadians consumed 15 billion contraband cigarettes in 1993, in Quebec province the market share was around 60%. Federal and Provincial Government losses were estimated at C\$ 2 billion per annum.

Before the reduction a typical (Quebec) RSP was C\$ 232/mille of which C\$ 176 was taxes, after the reduction the figures are RSP C\$ 118 and taxes C\$ 59. Quebec and Ontario followed the Federal lead and reduced respectively by C\$ 11 and C\$ 9/60 cents per carton, Nova Scotia and New Brunswick by C\$ 7 and finally PI by C\$ 9.25. Other provinces have not followed and so the reduction there is only the Federal C\$ 5/carton.

The reduction in cigarette smuggling has been dramatic. Quebec police authorities estimate a decline of 90%. Duty paid cigarette sales have correspondingly increased, it is too soon to say whether consumption has increased or whether consumers have simply transferred to legal product. The impact on the smugglers' business has been severe, but some increase in non-tobacco illicit trade is possible.

The previous enormous price differential between USA and Canadian duty paid product has gone, but there are now wide inter Province prices which does encourage some degree of inter Province 'trade'. Selling price examples are (Canadian \$ per carton)
USA (average) (23.00), Quebec (23.75), Ontario (24.96), Manitoba (45.83), New Brunswick (33.49), Alberta (40.87), Saskatchewan (46.63), British Columbia (49.93).

The tax reduction has been effective. Of course the other measures announced, e.g. tighter policing and packet print markings will have contributed. You have advised that other Governments around the world have been following the Canadian situation with interest. You should continue to use this example in your lobbying against penal and discriminatory indirect tax rates.

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