



# HOW MUCH IS **CONTRABAND TOBACCO** COSTING TAXPAYERS IN ONTARIO?

A Look at the Cigarette Allocation System on Reserves  
and the Overall Contraband Problem in Ontario

**2016 Update**

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# ABOUT THE CANADIAN TAXPAYERS FEDERATION



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The Canadian Taxpayers Federation (CTF) is a federally incorporated, not-for-profit citizen's group dedicated to lower taxes, less waste and accountable government. The CTF was founded in Saskatchewan in 1990 when the Association of Saskatchewan Taxpayers and the Resolution One Association of Alberta joined forces to create a national taxpayers organization. Today, the CTF has 89,000 supporters nationwide.

The CTF maintains a federal office in Ottawa and regional offices in British Columbia, Alberta, Prairie (SK and MB), Ontario, Quebec and Atlantic Canada. Regional offices conduct research and advocacy activities specific to their provinces in addition to acting as regional organizers of Canada-wide initiatives.

CTF offices field hundreds of media interviews each month, hold press conferences and issue regular news releases, commentaries, online postings and publications to advocate on behalf of CTF supporters. CTF representatives speak at functions, make presentations to government, meet with politicians, and organize petition drives, events and campaigns to mobilize citizens to affect public policy change. Each week CTF offices send out Let's Talk Taxes commentaries to more than 800 media outlets and personalities across Canada.

Any Canadian taxpayer committed to the CTF's mission is welcome to join at no cost and receive issue and Action Updates. Financial supporters can additionally receive the CTF's flagship publication The Taxpayer magazine published four times a year.

The CTF is independent of any institutional or partisan affiliations. All CTF staff, board and representatives are prohibited from holding a membership in any political party. In 2014-15 the CTF raised \$4.7 million on the strength of 30,663 donations. Donations to the CTF are not deductible as a charitable contribution.

# TABLE OF CONTENTS

I – Summary of Main Findings	1
II – Introduction	2
III – Why contraband tobacco matters	3
IV – Tobacco Taxes	6
V – Legal Tobacco Sold on Reserves	8
VI - Contraband Allocation Tobacco	15
VII - Tax Loss from On-Reserve Contraband Allocation Tobacco	18
VIII – Total tax evasion from contraband tobacco in Ontario	22
IX – Plain Packaging and Contraband Tobacco	25
X – Conclusion and Recommendations	27

# SUMMARY OF MAIN FINDINGS

**CTF Finding:** The overall contraband tobacco trade in Ontario cost between an estimated \$832.6 million to \$1.22 billion in lost federal and provincial tax revenue in 2014-15. This adds up to an estimated \$5.9 billion to \$9.2 billion over the last eight years.

**CTF Finding:** Between 260 and 393 million grams of contraband allocation tobacco was sold in Ontario on reserves in 2014-15, and between 2.291 and 3.45 billion grams over the last eight years. That's between 2.87 and 4.33 billion cigarettes over the last eight years. At its high end, that is 24 million packs in 2013-14, and 173 million packs over the last eight years.<sup>1</sup>

**CTF Finding:** In 2014-15 between 47% and 72% of all reported sales of tax-exempt allocation tobacco on Ontario aboriginal reserves were made illegally to people who were not Status Indians. This has created an estimated tax hole for the government of between \$407 million and \$617 million over the last eight years, averaging \$77.1 million per year. This has been increasing over time, spiking at between \$68 million and \$102 million in 2012-13.

**CTF Finding:** If all recorded allocation tobacco sold on Ontario reserves was for personal, legal use, Status Indians who are smokers would need to consume an estimated equivalent of 26 to 61 cigarettes a day. At its high end, that is almost 2 and a half packs a day.

<sup>1</sup>Assuming .797 grams per cigarette

# II INTRODUCTION: CONTRABAND TOBACCO

All tobacco sold in Canada is supposed to be sold from registered tobacco dealers, normal corner stores, grocery stores and tobacconists. Tobacco sold from these retailers are required, by law, to be marked with a stamp indicating that the wholesaler of that tobacco has paid the taxes and duties to the federal and provincial governments. This is known as 'marked tobacco.'

However, in some regions of the country – particularly in Ontario and Quebec – it's not uncommon for people to purchase 'unmarked tobacco' from an aboriginal reserve 'smoke shack' or from people working within the black market, selling bags of 'unmarked' cigarettes from the trunk of their car. While some contraband tobacco might still have a federal or provincial stamp on it, it is largely described as 'unmarked tobacco.' This means the tax has not been paid to the provincial and federal governments and as such, is usually significantly less expensive – hence its attractiveness.

One portion of 'unmarked' tobacco that is sold in Canada comes from a government established system to provide cigarettes to aboriginal reserves. Aboriginal reserves are allotted a ration of unmarked cigarettes for personal consumption through the Ontario government's Cigarette Allocation System (CAS). Of course, outside of the CAS, large quantities of 'unmarked' cigarettes make their way into the black market from aboriginal reserves as well. Even within the CAS however, the majority of tobacco sold on reserve ends up in the black market, as this report will demonstrate.

It is legal to sell this allocation tobacco on aboriginal reserves to Status Indians. However, when this allocation tobacco is sold to those who are not Status Indians, it is considered 'contraband tobacco.'

Contraband tobacco can come in several forms. Broadly, it is defined as any product that violates federal and/or provincial laws relating to tobacco taxation, manufacturing and distribution. This includes tax-exempt allocation tobacco sold from reserves to those who are not Status Indians, the sale of illegally imported tobacco without duties, stolen tobacco, tobacco produced in clandestine tobacco factories, and tobacco produced during off-hours (and off-the-books) in otherwise legitimate factories.<sup>2</sup>

The contraband tobacco trade has exploded over the last decade for several reasons. Chief among these are the incentives created by high tobacco excise taxes. As tobacco taxes have risen, so has the incentive to smuggle, produce and sell tobacco without the oversight of government, and therefore taxes.

Contraband tobacco is a wide-ranging problem with many tentacles. Because most aspects of the trade operate underground – often involving organized crime – it is extremely difficult to quantify. One aspect of the trade however – the sale of tax-free allocation tobacco to aboriginal reserves – is tracked by the Ontario government. Through Freedom of Information laws, the Canadian Taxpayers Federation (CTF) has obtained key Ontario government data that allows us to examine and estimate contraband allocation tobacco sold from reserves to those who are not Status Indians.

<sup>2</sup> Gabler, Nachum. "Combating the Contraband Tobacco Trade in Canada." Fraser Institute. December 2011. <http://www.fraserinstitute.org/research-news/display.aspx?id=2147483963>



# WHY CONTRABAND TOBACCO MATTERS

## TAX EVASION

Contraband tobacco is a major source of tax evasion in Canada. Despite the popularity of politicians cracking down on 'tax-cheats' and being seen to 'fight smoking,' cracking down on contraband tobacco remains politically sensitive. This is likely attributable to the inconvenient fact that the sale of illegal, contraband tobacco is a major source of income for some on-reserve Status Indians.

As a member of the *National Coalition Against Contraband Tobacco* (NCACT), the CTF believes that taxation should be low, efficient, fair and equal. We believe tobacco taxes should apply to all Canadians equally.

## UNFAIR TO LAW-ABIDING MERCHANTS

The sale of contraband tobacco creates an unfair disadvantage for merchants. Convenience store and gas station owners are forced to compete on radically uneven grounds. According to the *Canadian Convenience Stores Association*, its members lose an average of \$115,000 in sales every year due to contraband tobacco.<sup>3</sup> While the damage caused to law-abiding small businesses is beyond the scope of this report, it should be considered of equal importance to the damage done to taxpayers more broadly.

## EVASION OF ANTI-SMOKING EFFORTS

Contraband tobacco evades not only the governments' taxes, but also its anti-smoking campaigns. In many cases, contraband tobacco does not have any warning labels affixed, which are designed to educate and repel smokers from the product. Instead, they often are sold in non-descript plastic bags without anything indicating the harmful effects of tobacco.

### A tale of two cigarettes

Legal, marked cigarettes contain mandatory government warnings to discourage use.

Most tax-free cigarettes contain no warning of any kind.



Warning label on legal, marked cigarettes. Photograph: Health Canada



<sup>2</sup> Benzie, Robert and Brennan, Richard. "\$2 billion in tax revenue up in smoke." November 15, 2009. The Toronto Star. <http://www.thestar.com/news/investigations/article/726038--2-billion-in-tax-revenue-up-in-smoke>. Accessed November 3, 2015.

The government of Ontario requires that merchants hide tobacco products behind a visual barrier. This is done so that the 'power wall' of tobacco products is not used as an effective advertising instrument to potential smokers – youth in particular. By contrast, tobacco products sold from on-reserve 'smoke shacks' are often not hidden behind visual barriers as they are in off-reserve vendors.



Power Wall



Covered Display



Smoke Shack Display

Most importantly, contraband tobacco is able to beat the market price of legal tobacco several times over. This makes it easily accessible and affordable for anyone, including children. Since one of the objectives of high tobacco taxes is to dissuade people from smoking through economic disincentives, contraband tobacco renders this tool weak and ineffective.

## SUPPLY TO UNDER-AGE SMOKERS – CIGARETTE BUTTS DON'T LIE

A 2013 study found that on average, 21% of the 18,000 cigarette butts collected from 136 different locations in Ontario (hospitals, schools, casinos, GO train stations, malls, etc.) were illegal. That's approximately one in every five cigarettes.<sup>4</sup> Contraband tobacco is easily available to under-age smokers and is a major source of tobacco for youth.

## SMOKING RATES FOR ABORIGINALS

The tax-free status of tobacco on-reserve – including legal allocation tobacco for personal use by Status Indians – makes anti-smoking efforts extremely ineffective for aboriginals. Aboriginals have a higher than average smoking rate, with some studies finding aboriginal smoking rates on average twice as high as non-Aboriginals Canadians.<sup>5</sup> We have relied on an on-reserve aboriginal smoking rate of 43.2%, based on data from the First Nations Information Governance Centre.<sup>6</sup> However, some data suggests an even higher smoking rate of 59% for on reserve Status Indians.<sup>7</sup>

According to a report by *Physicians for a Smoke-Free Canada*, “already high rates of tobacco use in First Nation communities will increase further still and no credible anti-tobacco efforts can be mounted as long as cigarettes are easily available at bargain-basement prices.”<sup>8</sup>

<sup>4</sup> Canadian Convenience Stores Association, 'Contraband Tobacco Butt Study'. December 9, 2013. <http://ontariocstores.ca/shocking-contraband-butt-study-results/>

<sup>5</sup> Physicians for a Smoke Free Canada, 'Smoking among Aboriginal Canadians'. February, 2013. <http://www.smoke-free.ca/factsheets/pdf/cchs/aboriginal.pdf>

<sup>6</sup> First Nations Information Governance Centre, 'Survey RHS 2008/10". <http://data.fnigc.ca/online>

<sup>7</sup> Health Canada, 'First Nations and Inuit Health – Tobacco'. June 24, 2014. <http://www.hc-sc.gc.ca/fnihah-spnia/substan/tobac-tabac/index-eng.php>

<sup>8</sup>“Towards effective tobacco control in First Nations and Inuit communities.”

[Physicians for a Smoke Free Canada. March 2007. http://www.smoke-free.ca/pdf\\_1/Effective%20tobacco%20control%203.pdf](http://www.smoke-free.ca/pdf_1/Effective%20tobacco%20control%203.pdf)

## ORGANIZED CRIME

Contraband tobacco is also a major source of revenue for organized crime. According to the RCMP, trafficking in contraband tobacco involves over 175 criminal organizations,<sup>9</sup> including the Hells Angels.

The RCMP make regular raids against illegal tobacco operations across Canada. For example, in January 2014, the RCMP seized 964,800 contraband cigarettes as well as six firearms during a raid at Dakota Plains First Nation.<sup>10</sup>

By creating an incentive for the black market, government policy creates a large source of revenue for the worst elements of society.

## UNFAIR TO LAW-ABIDING SMOKERS

Finally, the sale of contraband tobacco is unfair to law-abiding smokers. Smokers who buy their tobacco from legitimate merchants make a substantial contribution to government revenues. In November 2014, 40% of cigarettes purchased within the most recent four weeks in Ontario were contraband.<sup>11</sup> It is simply unfair to those smokers who pay their taxes that others may choose to buy illegally from tax-exempt dealers.



<sup>9</sup> Elliott, William J.S..Public Safety Canada.Royal Canadian Mounted Police.2011 Contraband Tobacco Enforcement Strategy. Ottawa: Her Majesty the Queen in Right of Canada, 2011. <http://www.rcmp-grc.gc.ca/pubs/tobac-tabac/2011-contr-strat/2011-eng.pdf>

<sup>10</sup> Royal Canadian Mounted Police, 'RCMP and Manitoba Finance make large seizure of contraband tobacco and firearms during Project Debit'. January 30, 2014. <http://www.rcmp-grc.gc.ca/mb/news-nouvelles/2014/project-debit-20140120-eng.htm>

<sup>11</sup> National Coalition Against Contraband Tobacco, 'Contraband Tobacco Monitoring Survey Results, October 2013 – October 2014'. November 28, 2014. [http://stopcontrabandtobacco.ca/wp-content/uploads/2012/02/NCCT\\_CONTRABANDMONITOR\\_2014-11\\_ONTARIO\\_ForPR.pdf](http://stopcontrabandtobacco.ca/wp-content/uploads/2012/02/NCCT_CONTRABANDMONITOR_2014-11_ONTARIO_ForPR.pdf)

# IV TOBACCO TAXES

## RAISON D'ETRE

Tobacco taxes – like most ‘sin taxes’ – are generally imposed for the purposes of:

1. Raising revenue;
2. Cost externalization (such as health care); and
3. Discouraging consumption.<sup>12</sup>

While credible economic literature can be found to either support or refute these reasons for tobacco taxes, different governments place different degrees of emphasis on each of these justifications.

Regardless of the reasons used, high tobacco taxes are now the norm in the developed world.

## HOW TOBACCO TAXES WORK IN ONTARIO

Canada’s tobacco tax system varies by province. In addition to the federal tobacco tax of \$0.10515 per gram of tobacco, each province has its own varying levels of a tobacco tax. In Ontario, the tobacco tax is \$0.15475. This is an increase from the previous rate of \$0.13975 per gram, and before that \$0.1235 per gram. For the purposes of this report, for the 2014-15 analysis we will be applying the \$0.13975 provincial rate, and not the tax hike that only recently came into effect.

The Harmonized Sales Tax (HST) of 13% is also charged on the combined price of the actual tobacco and the provincial tobacco taxes, so that there is a tax-on-tax. The applied HST for the years 2012-13 to 2015-16 are as follows:

Years	HST per gram
2012-13	<b>\$0.053</b>
2013-14	<b>\$0.054</b>
2014-15	<b>\$0.059</b>
2015-16	<b>\$0.062</b>

The calculations for the application of all taxes on tobacco for various years are laid out in Appendix I. To summarize, the total taxes from 2012-13 to 2015-16 are as follows:

Years	Taxes per gram	Taxes per cigarette	Taxes per pack <sup>13</sup>
2012-13	<b>\$0.2595</b>	\$0.2068	\$5.17
2013-14	<b>\$0.28165</b>	\$0.2245	\$5.61
2014-15	<b>\$0.3039</b>	\$0.2422	\$6.06
2015-16	<b>\$0.3214</b>	\$0.2562	\$6.40

<sup>12</sup> Trussler, Simon & Dr. Meschi, Meloria. A review of the economic literature on tobacco taxation. FTI Holdings Limited. March 2011. page 7.

<sup>13</sup> <http://www.cra-arc.gc.ca/E/pub/em/edn35/edn35-e.htm>

It should be noted that for the purpose of calculating contraband risk, the federal excise tax is applied by wholesalers. So there is little contraband risk associated with federal excise tax, and therefore in the tax loss portion of this report (Section VII), federal excise taxes have been omitted from the calculations.

## TOBACCO TAXES ACROSS CANADA

### Taxes on tobacco (per cigarette) by province, 2016

	NFLD	PEI	NS	NB	QC	ON	MB	SK	AB	BC
<b>Provincial tobacco tax</b>	\$0.245	\$0.25	\$0.2752	\$0.2226	\$0.149	\$0.15475	\$0.295	\$0.25	\$0.25	\$0.239
<b>Federal tobacco tax</b>	\$0.10515	\$0.10515	\$0.10515	\$0.10515	\$0.10515	\$0.10515	\$0.10515	\$0.10515	\$0.10515	\$0.10515
<b>Total tobacco taxes</b>	\$0.34015	\$0.35515	\$0.36036	\$0.32775	\$0.25415	\$0.2599	\$0.40015	\$0.35515	\$0.35515	\$0.34415
<b>Total sales taxes</b>	15%	15%	15%	15%	14.975%	13%	13%	10%	5%	12%

# V LEGAL TOBACCO SOLD ON RESERVES

## CIGARETTE ALLOCATION SYSTEM (CAS)

The tobacco tax applies to all tobacco products sold in Ontario including cigarettes, cigars, loose tobacco and several other products. Every consumer who purchases tobacco products in Ontario must pay tobacco taxes through a registered tobacco retail dealer. Status Indians are exempt from both provincial excise and the HST when purchasing products on-reserve upon presentation of a Certificate of Indian Status (CIS) card.<sup>15</sup> Those without a CIS card are prohibited by law from purchasing tax-exempt tobacco from aboriginal reserve merchants. Status Indians still pay the federal tobacco excise tax since it is levied at the wholesale level.

This exemption flows from section 87 of the Indian Act, which exempts the personal property of a registered Status Indian situated on a reserve from taxation by the Crown.

However, while aboriginal reserve merchants can sell tax-exempt tobacco to Status Indians, the Ontario government limits the amount of tobacco these merchants can sell. They do so because they want “to prevent the purchase of excess quantities of unmarked cigarettes that could be resold to non-Indians.”<sup>16</sup> Under the First Nations Cigarette Allocation System (CAS), the Ontario government allows wholesalers and retailers a quantity of tobacco based on:

- On-reserve and off-reserve adult populations;
- Smoking patterns for aboriginals; and
- Special events on the reserve.<sup>17</sup>

The CAS determines the weight of the factors above with this formula:

**R** = the number of individuals in the reserve community

**OR** = the number of individuals in the off-reserve community

**A** = annual allocation quantity in cartons

$$[(R * 2.5 * 0.423) + (OR * 2.7 * 0.423)] * 12 = A^{18}$$

This annual amount can be increased by up to 30% if there are special events on reserve where Status Indians who are not members of the on or off-reserve community would be purchasing tobacco, and if the local band council has entered into a retail agreement with the Ontario government.

It is interesting to note that based on this formula, off-reserve Status Indians qualify for a greater cigarette allocation than on-reserve Status Indians.

<sup>15</sup> Elliott, William J.S..Public Safety Canada.Royal Canadian Mounted Police.2008 Contraband Tobacco Enforcement Strategy. Ottawa: Her Majesty the Queen in Right of Canada, 2008. Web.<http://www.rcmp-grc.gc.ca/pubs/tobac-tabac/tobacco-tabac-strat-2008-eng.pdf>

<sup>16</sup> Ontario Provincial Government.Ontario Ministry of Finance.First Nations Cigarette Allocation System. Toronto: Queen's Printer for Ontario, 2015. <http://www.fin.gov.on.ca/publication/tobacco-first-nations-cigarette-allocation-en.pdf>

<sup>17</sup> Ontario Provincial Government.Ontario Ministry of Finance.First Nations Cigarette Allocation System. Toronto: Queen's Printer for Ontario, 2015. <http://www.fin.gov.on.ca/publication/tobacco-first-nations-cigarette-allocation-en.pdf>

<sup>18</sup> Ontario Regulation 649/94: Sales of Unmarked Cigarettes on Indian Reserves." Tobacco Tax Act.Government of Ontario. [http://www.e-laws.gov.on.ca/html/regs/english/elaws\\_regs\\_930649\\_e.htm](http://www.e-laws.gov.on.ca/html/regs/english/elaws_regs_930649_e.htm)

Take for example, the reserve of Walpole Island, located in Southwestern Ontario on the border between Michigan and Ontario. As of March 2016, Walpole Island had a registered on-reserve population of 2,325 and an off-reserve population of 2,451. There are also 23 individuals of Wapole Island who are living on other reserves (who we will count towards the on-reserve population).<sup>19</sup>

Applying the formula,

**R** = 2,348

**OR** = 2,451

$$[(2,348 * 2.5 * 0.423) + (2,451 * 2.7 * 0.423)] * 12 = \mathbf{A}$$

$$(2,483.01 + 2799.29) * 12 = \mathbf{A}$$

$$5,282.3 * 12 = 63,387.6$$

According to the formula, Wapole Island receives a cigarette allocation of 63,387.6 cartons, or 12,677,520 cigarettes a year.

Walpole Island is a large reserve, and receives a higher than average allocation. According to *Physicians for a Smoke-Free Canada*, Ontario's quota system allocates about 3,000 tax-free cigarettes per person on the reserve per year.<sup>20</sup>

The Ontario Ministry of Finance requires by law that:

The on-reserve retailers must sell allocation cigarettes *only to First Nations individuals who are buying the allocation cigarettes on a reserve for their exclusive use.*<sup>21</sup>

According to the Auditor General of Ontario:

Manufacturers and wholesalers with operations on-reserve sold significantly more cigarettes to reserves than was reasonable. For instance, one of these manufacturers/wholesalers sold, to 16 reserves, an average of 27 cartons per month (5,400 cigarettes) for every adult band member who smoked, and to another reserve over 400 cartons per month. These quantities are well beyond what could be reasonably assumed to be for personal use and almost certainly included cigarettes destined for sale to non-band members.<sup>22</sup>

### 'SMOKE SHACKS'

The loose enforcement of tax exemptions has resulted in so-called 'smoke shacks' located on aboriginal reserves illegally selling tax-exempt allocation tobacco to Canadians who are not Status Indians on a mass scale. While those who are not Status Indians are, by law, to be turned away, it is a poorly kept secret that they are in fact welcomed customers. The National Coalition Against Contraband Tobacco estimates that there are more than 350 smoke shacks in Canada.<sup>23</sup>

While the federal and Ontario governments have claimed to be cracking down on the contraband tobacco trade, they have demonstrated considerable timidity towards cracking down on smoke shacks directly.

<sup>19</sup> Aboriginal Affairs and Northern Development Canada, "Registered Population, Walpole Island", March, 2016. [http://pse5-esd5.ainc-inac.gc.ca/FNP/Main/Search/FNRegPopulation.aspx?BAND\\_NUMBER=170&lang=eng](http://pse5-esd5.ainc-inac.gc.ca/FNP/Main/Search/FNRegPopulation.aspx?BAND_NUMBER=170&lang=eng)

<sup>20</sup> "Towards effective tobacco control in First Nations and Inuit communities." Physicians for a Smoke-Free Canada. March 2007. [http://www.smoke-free.ca/pdf\\_1/Effective%20tobacco%20control%203.pdf](http://www.smoke-free.ca/pdf_1/Effective%20tobacco%20control%203.pdf)

<sup>21</sup> Ontario Provincial Government. Ontario Ministry of Finance. First Nations Cigarette Allocation System. Toronto: Queen's Printer for Ontario, 2015. <http://www.fin.gov.on.ca/publication/tobacco-first-nations-cigarette-allocation-en.pdf>

<sup>22</sup> "2010 Annual Report of the Office of the Auditor General of Ontario." Office of the Auditor General of Ontario. [http://www.auditor.on.ca/en/reports\\_en/en10/410en10.pdf](http://www.auditor.on.ca/en/reports_en/en10/410en10.pdf)

<sup>23</sup> National Coalition Against Contraband Tobacco, 'Contraband Tobacco in Canada – An Assessment on the Fifth Anniversary of the RCMP's Contraband Tobacco Enforcement Strategy', May 7, 2013. <http://stopcontrabandtobacco.ca/wp-content/uploads/2012/02/Contraband%20Tobacco%20in%20Canada-%20An%20Assessment%20on%20the%205th%20Anniversary%20of%20the%20RCMPs%20Contraband%20Tobacco%20Enforcement%20Strategy.pdf>

## TAX COLLECTING

Registered importers and wholesalers designated by provincial authorities as collectors of tobacco tax report and remit the tax monthly. They reimburse themselves by collecting an amount equal to the tax when they sell tobacco products to non-collectors, such as retailers.

A 2008 review by the Auditor General of Ontario found that:

Although all seven of the large gasoline and diesel-fuel tax collectors had been audited every four years as planned, only a few of the 38 large tobacco tax collectors had been audited at least once every four years as planned.<sup>24</sup>

While a follow-up report by the Auditor General found that improvement has been made, progress has been slow.<sup>25</sup>

Although the Ontario government limits the number of untaxed allocation cigarettes that can be sold on reserve, they (along with Nunavut and the Yukon Territory) do not limit the sales of untaxed cigars on aboriginal reserves. As of 2010, the Ontario Ministry of Revenue was only considering options for reform, despite clear recommendations from the Auditor General to establish an unenforceable cigar allocation system.

## TAX-EXEMPT TOBACCO SALES

This study's primary source of data is a table titled 'Exempt Tobacco Sales on First Nation Reserves in Ontario' obtained by the Canadian Taxpayers Federation through the Freedom of Information (FOI) Act from the Ontario Ministry of Finance. This document details the total, recorded quantity of allocation cigarettes, cigars and other tobacco products sold on aboriginal reserves in Ontario. Of note, it also includes the provincial tobacco tax value of these tobacco products, rather than how much tax was actually collected, as that would be nil.

<sup>24</sup> "2008 Annual Report of the Office of the Auditor General of Ontario." Office of the Auditor General of Ontario. [http://www.auditor.on.ca/en/content/annualreports/arreports/en08/ar\\_en08.pdf](http://www.auditor.on.ca/en/content/annualreports/arreports/en08/ar_en08.pdf)

<sup>25</sup> "2010 Annual Report of the Office of the Auditor General of Ontario." Office of the Auditor General of Ontario. [http://www.auditor.on.ca/en/content/annualreports/arreports/en10/2010ar\\_en.pdf](http://www.auditor.on.ca/en/content/annualreports/arreports/en10/2010ar_en.pdf)

## EXEMPT ALLOCATION TOBACCO SALES ON FIRST NATION RESERVES IN ONTARIO, 2005/06 – 2014/15

	<b>Cigarettes</b> (millions of grams)	<b>Other</b> (millions of grams)	<b>Provincial Tobacco Rate</b> Cigarettes & Others	<b>Cigarette &amp; Other Provincial Tobacco Tax Value</b> (millions)	<b>Cigars</b> (millions)	<b>Provincial Tobacco Tax Rate</b> Cigars	<b>Cigar Provincial Tobacco Tax Value</b> (millions)	<b>Total Provincial Tobacco Tax Value</b> (millions)
<b>2005-06</b>	295	n/a	\$0.11725 per gm	\$34.64	83	\$0.33 per cigar	\$27.40	\$62.03
<b>2006-07</b>	339	n/a	\$0.1235 per gm	\$41.85	80	\$0.33 per cigar	\$26.30	\$68.15
<b>2007-08</b>	318	41	\$0.1235 per gm	\$44.37	89	\$0.33 per cigar	\$29.52	\$73.88
<b>2008-09</b>	285	33	\$0.1235 per gm	\$39.30	92	\$0.33 per cigar	\$30.35	\$69.66
<b>2009-10</b>	291	30	\$0.1235 per gm	\$39.68	86	\$0.33 per cigar	\$28.08	\$67.76
<b>2010-11</b>	232	30	\$0.1235 per gm	\$43.63	76	\$0.33 per cigar	\$25.04	\$68.67
<b>2011-12</b>	341	42	\$0.1235 per gm	\$47.34	70	\$0.33 per cigar	\$23.10	\$70.44
<b>2012-13</b>	332	74	\$0.1235 per gm	\$50.19	87	\$0.33 per cigar	\$28.67	\$78.86
<b>2013-14</b>	346	57	\$0.1235 per gm <sup>26</sup>	\$49.86	78	\$0.33 per cigar	\$25.86	\$75.72
<b>2014-15</b>	347	44	0.1235 per gm <sup>27</sup>	\$54.19	60	\$0.33 per cigar	\$19.90	\$74.09

**Source:** Canadian Taxpayers Federation, 2016 with data from Ontario Ministry of Finance, 'Exempt Tobacco Sales on aboriginal reserves in Ontario, 2012-2014' released under the Freedom of Information (FOI) Act

**Notes:**

- Tobacco tax figures do not include HST
- Other = grams
- Data for Foreign Tobacco Tax Revenue is not available

<sup>26</sup> The Ontario provincial tax rate on tobacco products in Ontario increased on May 2, 2014, to \$0.13975 per gm

<sup>27</sup> The tobacco tax rate changed effective May 2, 2014 to \$0.13975 per stick or gram

Run against other statistics, this report estimates the sale of legal allocation tobacco to Status Indians, and how much is sold illegally to Canadians without Indian status.

It should be noted that for data compatibility purposes this report divides the tobacco tax value of cigars by the per gram rate of cigarettes or other loose tobacco. This blends all tobacco products into a single per gram tobacco unit. Using 2014-15 as an example:

**TV** = tax value of cigars

**OT** = Ontario tobacco tax rate per gram

**CQ** = cigar quantity by gram

$$\mathbf{TV / OT = CQ}$$

**TV** = \$19.90 million (2014-15)

**OT** = \$0.1235 per gram

**CQ** = 161.1 million grams of cigar tobacco (estimate)<sup>28</sup>

Taken together with reported sales of allocation loose tobacco and cigarettes, this report estimates total tax-exempt tobacco sales of approximately 552.1 million grams of tobacco in 2014-15.<sup>29</sup> This is the equivalent of 692.7 million cigarettes.<sup>30</sup>

## **DETERMINING LEGAL TAX-EXEMPT ALLOCATION TOBACCO SALES ON-RESERVE**

In order to estimate the quantity of contraband allocation tobacco sold on-reserve to those who are not Status Indians, we must determine how much is legally sold to Status Indian smokers. This estimate is made by using the aboriginal smoking rate, the population of Status Indians in Ontario and information on how many cigarettes (or grams of tobacco) the average Status Indian smoker would consumer in a year.

This report uses two data points for Status Indian populations: the on-reserve population and the total Status Indian population. While all Status Indians are entitled to tax-free allocation tobacco, it is unlikely that these individuals living in urban centres like Toronto or Ottawa will travel long distances on a frequent basis in order to obtain allocation tobacco on any mass scale. As such, this report produces all of its figures using both the on-reserve Status Indian population, and a much more conservative estimate using the total Status Indian population in Ontario.

This report estimates the quantity of allocation tobacco legally sold on-reserve through a basic formula.

### **2013-14**

**A** = average grams of tobacco consumed per year by smokers

**P** = population of Status Indians in Ontario who are age 15 and older

**S** = percentage of aboriginal people who are smokers

**L** = legal allocation tobacco sold on aboriginal reserves in Ontario

$$\mathbf{A * P * S = L}$$

**A** = 5,475 cigarettes (4,364 grams)<sup>31</sup>

**P** = 71,247 Status Indians on-reserve aged 15 and older<sup>32</sup>

**S** = 43.2% of the on-reserve population smokes<sup>33</sup>

**L** = 134.3 million grams of allocation tobacco are sold legally on Ontario reserves<sup>34</sup>

<sup>28</sup> For 2012-13 this number is 232 million grams of cigar tobacco (estimate); for 2013-14 this number is 209.4 million grams of cigar tobacco (estimate)

<sup>29</sup> For 2012-13 this number is 637 million grams of tobacco. The equivalent of 799 million cigarettes; for 2013-14 this number is 613 million grams of tobacco. The equivalent of 769.1 million cigarettes.

<sup>30</sup> Based on per gram cigarette content of 0.797.

<sup>31</sup> Reid JL, Hammond D, Rynard VL, Burkhalter R. Tobacco Use in Canada: Patterns and Trends, 2014 Edition. Waterloo, ON: Propel Centre for Population Health Impact, University of Waterloo.

<sup>32</sup> Data obtained from AADNC Statistics Branch.

<sup>33</sup> First Nations Information Governance Centre, 'Survey RHS 2008/10' <http://data.fnigc.ca/online>

<sup>34</sup> For 2012-13 this number was 117.3 million

## 2014-15

**A** = 5,073.5 cigarettes per year (4,043.6 grams)<sup>35</sup>

**P** = 72,489 Status Indians on-reserve aged 15 and older<sup>36</sup>

**S** = 43.2% of the on-reserve population smokes<sup>37</sup>

**L** = 126.6 million grams of allocation tobacco are sold legally on Ontario reserves<sup>38</sup>

**CTF Finding:** Based on known smoking rates for aboriginals and only the on-reserve population, this report estimates that 126.6 million grams of the 552.1 million grams of allocation tobacco, sold on reserves was sold legally in 2014-15. This translates into 23% of total on-reserve allocation sales in 2014-15 being sold legally.

Put another way, of an estimated 692.7 million equivalent allocation cigarettes sold from reserves, just 158.8 million were legal. That works out to just 6.4 million of 27.7 million packs.

Including the *entire Status Indian population in Ontario over 15*,<sup>39</sup> this report estimates that 292 million grams of the 552.1 million grams of allocation tobacco was sold legally from Indian reserves, or 53%.

As an additional illustration, this report calculates the number of allocation cigarettes that would have to be consumed, both by those who are smokers on-reserve and off-reserve. As in, if it is claimed that if every allocation cigarette purchased is purchased by a Status Indian for personal consumption, just how many allocation cigarettes would they need to consume each year?

## DETERMINING HOW MUCH ALLOCATION TOBACCO STATUS INDIAN SMOKERS WOULD HAVE TO CONSUME

To determine how much tobacco Status Indians who smoke would have to consume for all allocation sales on-reserve to be legal, this report uses the following formula:

**T** = total allocation tobacco sold on-reserve

**S** = percentage of aboriginal people who are smokers

**P** = population of on-reserve Status Indians in Ontario aged 15 and older

**W** = amount of allocation tobacco (grams) Status Indian smokers would have to consume

$$T / (S * P) = W$$

## 2013-14

**T** = 613 million grams of tobacco<sup>40</sup>

**P** = 71,247 Status Indians on-reserve aged 15 and older<sup>41</sup>

**S** = 43.2% of the on-reserve population smokes<sup>42</sup>

**W = an estimated 19,916grams would have to be consumed by smokers annually who are Status Indians living on-reserve (2013-14), or 24,989cigarettes per year**

<sup>35</sup> Reid JL, Hammond D, Rynard VL, Burkhalter R. Tobacco Use in Canada: Patterns and Trends, 2015 Edition. Waterloo, ON: Propel Centre for Population Health Impact, University of Waterloo. [http://www.tobaccoreport.ca/2014/TobaccoUseinCanada\\_2014.pdf](http://www.tobaccoreport.ca/2014/TobaccoUseinCanada_2014.pdf)

<sup>36</sup> Data obtained from AADNC Statistics Branch.

<sup>37</sup> First Nations Information Governance Centre, "Survey RHS 2008/10". <http://data.fnigc.ca/online>

<sup>38</sup> For 2012-13 this number was 117.3 million

<sup>39</sup> 167,243 for 2015, according to data provided by AADNC which results in a calculation of  $4,043.6 * 167,243 * .432 = 292,145,959.35$

<sup>40</sup> Canadian Taxpayers Federation, 2013-14 with data from Ontario Ministry of Finance, "Exempt Tobacco Sales on Indian Reserves 2012-2014" released under the Freedom of Information Act. Calculated by author, Christine Van Geyn; Canadian Taxpayers Federation, 2014-15 with data from Ontario Ministry of Finance, "Exempt Tobacco Sales on Indian Reserves 2014-2015" released under the Freedom of Information Act. Calculated by author, Christine Van Geyn.

<sup>41</sup> Data obtained from AADNC Statistics Branch.

<sup>42</sup> First Nations Information Governance Centre, "Survey RHS 2008/10". <http://data.fnigc.ca/online>

## 2014-15

T = 552.1 million grams of tobacco

P = 72,489 Status Indians on-reserve aged 15 and older<sup>43</sup>

S = 43.2% of the on-reserve population smokes<sup>44</sup>

**W = an estimated 17,630.4 grams would have to be consumed by smokers annually who are Status Indians living on-reserve (2014-15), or 22,120 cigarettes per year.**

**CTF Finding:** Using just the on-reserve population, aboriginal smokers would need to consume an estimated equivalent of 61 cigarettes a day (2.4 packs) for all allocation sales to be legal.

Including the *entire Status Indian population in Ontario over 15*,<sup>45</sup> aboriginal smokers would need to consume the equivalent of 26 cigarettes a day (just over 1 pack) – not including any tobacco purchased off-reserve.

<sup>43</sup> Data obtained from AADNC Statistics Branch.

<sup>44</sup> First Nations Information Governance Centre, "Survey RHS 2008/10". <http://data.fnigc.ca/online>

<sup>45</sup> 167,243 in 2014-15(according to AADNC Statistics Branch)  $552,100,000 * / (.432 * 167,243) = 7,642$  grams. That's 9,587 cigarettes per year.

# VI

## CONTRABAND ALLOCATION TOBACCO

### **DETERMINING TAX EXEMPT CONTRABAND ALLOCATION TOBACCO SALES ON-RESERVE**

Now that we've illustrated that it's virtually impossible that all the allocation tobacco sold on-reserve is sold legally to Status Indians, we can estimate how much is sold illegally on-reserve.

This portion of the report estimates the quantity of illegal, contraband allocation tobacco sold on-reserve through a similarly basic formula.

### **2013-14**

**T** = total allocation tobacco sold on Ontario reserves  
(calculated in section IV)

**L** = legal allocation tobacco sold on Ontario reserves  
(calculated in section V)

**C** = contraband allocation tobacco sold on Ontario reserves

$$\mathbf{T - L = C}$$

**T** = 613 million grams of allocation tobacco (2013-14)

**L** = 134.3 million grams of allocation tobacco are sold legally on Ontario reserves (2013-14, using on reserve population)

**C = 478.7 million grams of allocation tobacco are illegally sold as contraband (2013-14)**

### **2014-15**

**T** = 552.1 million grams of allocation tobacco (2014-15)

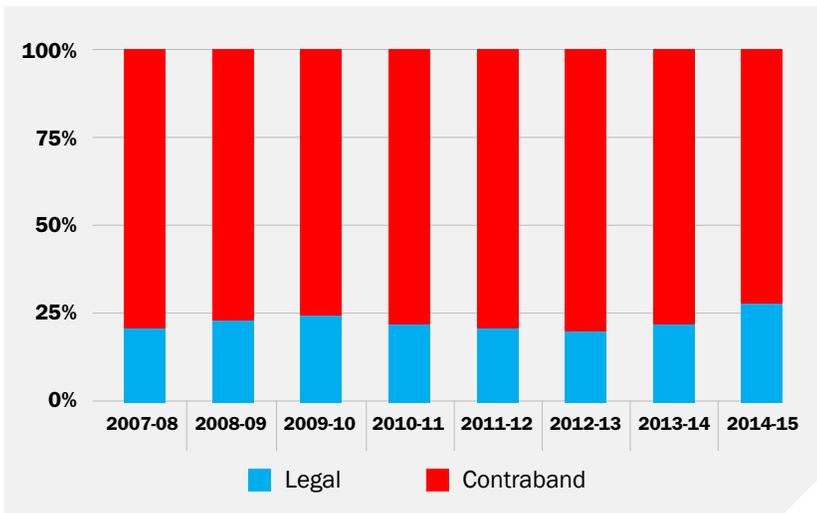
**L** = 126.6 million grams of allocation tobacco are sold legally on Ontario reserves (2014-15, using on reserve population)

**C = 425.5 million grams of allocation tobacco are illegally sold as contraband (2014-15)**

## ALLOCATION TOBACCO SOLD ON ONTARIO RESERVES, 2007-08 TO 2014-15

	2007-08		2008-09		2009-10		2010-11		2011-12		2012-13		2013-14		2014-15	
	Res. Pop.	Total Pop. <sup>46</sup>	Res. Pop.	Total Pop. <sup>47</sup>	Res. Pop.	Total Pop.										
<b>Total grams (mil)</b>	546	546	505	505	508	508	540	540	570	570	637	637	613	613	552	552
<b>Legal grams (mil)</b>	113	245	115	250	132	281	120	262	122	268	127	283	134	302	159	292
<b>Contraband grams (mil)</b>	<b>434</b>	<b>301</b>	<b>391</b>	<b>255</b>	<b>376</b>	<b>228</b>	<b>420</b>	<b>279</b>	<b>448</b>	<b>303</b>	<b>510</b>	<b>354</b>	<b>478</b>	<b>311</b>	<b>393</b>	<b>260</b>
<b>Legal (% of total)</b>	<b>21%</b>	<b>45%</b>	<b>23%</b>	<b>50%</b>	<b>26%</b>	<b>55%</b>	<b>22%</b>	<b>48%</b>	<b>21%</b>	<b>47%</b>	<b>20%</b>	<b>55%</b>	<b>22%</b>	<b>49%</b>	<b>28%</b>	<b>53%</b>
<b>Contraband (% of total)</b>	<b>79%</b>	<b>55%</b>	<b>77%</b>	<b>50%</b>	<b>75%</b>	<b>45%</b>	<b>78%</b>	<b>52%</b>	<b>79%</b>	<b>54%</b>	<b>80%</b>	<b>45%</b>	<b>78%</b>	<b>51%</b>	<b>72%</b>	<b>47%</b>

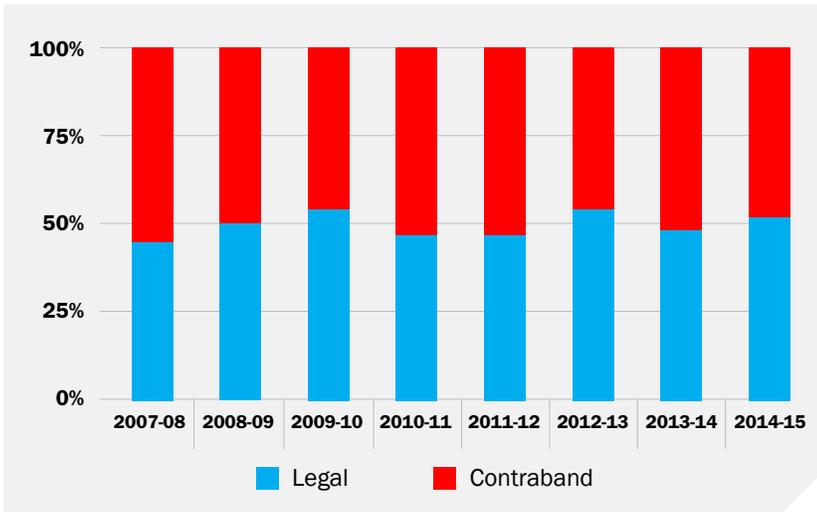
## CONTRABAND TOBACCO AS A % OF TOTAL RECORDED ALLOCATION SALES FROM ONTARIO RESERVES, 2007-08 TO 2014-15 (USING ON RESERVE POPULATION)



<sup>46</sup> Data obtained from AADNC Statistics Branch.

<sup>47</sup> Data obtained from AADNC Statistics Branch.

**CONTRABAND TOBACCO AS A % OF TOTAL RECORDED ALLOCATION SALES FROM ONTARIO RESERVES, 2007-08 TO 2014-15 (USING TOTAL STATUS INDIAN POPULATION OVER 15)**



**CTF Finding:** Using the *on reserve population*, this report estimates that 510 million grams of tax-exempt tobacco were sold illegally on Ontario’s reserves in 2012-13, 478 million grams in 2013-14, and 393 million grams in 2014-15. This represents 80%, 78% and 72% of all allocation sales from reserves for those years, respectively. These figures do not include unrecorded sales of contraband tobacco.

Using the *entire Status Indian population of Ontario over 15*, this report estimates that 311 million grams of tax-exempt allocation tobacco sold from reserves was illegal in 2013-14, and 260 million grams in 2014-15. This accounts for 51% and 47% of total sales in 2013-14 and 2014-15.

## VII

TAX LOSS FROM ON-RESERVE  
CONTRABAND ALLOCATION TOBACCO**DETERMINING THE TAX LOSS  
FROM TAX EXEMPT CONTRABAND  
ALLOCATION TOBACCO SALES**

As stated previously, tobacco is taxed at \$0.10515 per cigarette by the federal government. Tobacco was taxed at a rate of \$0.1235 per cigarette in Ontario in 2014, and at a rate of \$0.13975 per cigarette in 2015. Effective as of midnight of the 2016 Ontario budget, the provincial tax rate per cigarette increased to \$0.15475.<sup>48</sup>

And starting in 2017, Ontario will increase tobacco taxes with the rate of inflation.

The Harmonized Sales Tax (HST) of 13% is also charged on the combined price of the actual tobacco and the tobacco taxes. This constitutes a tax-on-tax.

The March 2013 average pre-tax price in Ontario per cigarette was \$0.1474.<sup>49</sup> The April 2014 average pre-tax price in Ontario per cigarette was \$0.1474.<sup>50</sup>

The October 2015 average pre-tax price in Ontario per cigarette was \$0.1695.<sup>51</sup>

The March 2016 average pre-tax price in Ontario per cigarette was \$0.1699.<sup>52</sup>

The combined federal and provincial tobacco and sales taxes added up to an estimated \$0.27765 per cigarette in 2014, to \$0.2989 per cigarette in 2015, and to \$0.31575 per cigarette in March 2016. That's \$6.94 per pack in taxes alone in 2014, \$7.47 in 2015, and \$7.89 in 2016.

Since Status Indians and Canadians at-large alike pay the federal tobacco excise tax through wholesalers, it is not a major problem from the perspective of contraband allocation tobacco. **Therefore, the federal tobacco excise tax is excluded from these calculations.**

**2012-13**

**OT** = Ontario tobacco tax

**HST** = Harmonized sales tax

**TT** = total applicable tobacco taxes per cigarette

**OT + HST = TT**

**OT** = \$0.1235 per cigarette Ontario tobacco tax

**HST** = 13% tax applied to (\$0.1473 average 2013 cigarette price + \$0.1235 OT) = \$0.035204

**TT = \$0.1587 per cigarette (\$0.1991 per gram)**

<sup>48</sup> Ontario Ministry of Finance, Tobacco Tax. April, 2016. <http://www.fin.gov.on.ca/en/tax/tt/>

<sup>49</sup> Non-Smokers' Rights Association, 'Cigarette prices in Canada, March 2013'. March 2013. [http://www.nusra-adnf.ca/cms/file/files/130321\\_map\\_and\\_table.pdf](http://www.nusra-adnf.ca/cms/file/files/130321_map_and_table.pdf)

<sup>50</sup> Non-Smokers' Rights Association, 'Cigarette prices in Canada, April 2014'. April 2014. [http://www.nusra-adnf.ca/cms/file/files/140401\\_map\\_and\\_table.pdf](http://www.nusra-adnf.ca/cms/file/files/140401_map_and_table.pdf)

<sup>51</sup> Non-Smokers' Rights Association, 'Cigarette prices in Canada, October 2015'. October 2015. [http://www.nusra-adnf.ca/cms/file/files/151028\\_map\\_and\\_table.pdf](http://www.nusra-adnf.ca/cms/file/files/151028_map_and_table.pdf)

<sup>52</sup> Non-Smokers' Rights Association, 'Cigarette prices in Canada, March 2016'. March 2016. [http://www.nusra-adnf.ca/cms/file/files/160322\\_map\\_and\\_table.pdf](http://www.nusra-adnf.ca/cms/file/files/160322_map_and_table.pdf)

## 2013-14

**OT** = \$0.1235 per cigarette Ontario tobacco tax  
**HST** = 13% tax applied to (\$0.1474 average 2014 cigarette price + \$0.1235 OT) = \$0.035217

**TT = \$0.1587 per cigarette (\$0.1991 per gram)**

## 2014-15

**OT** = \$0.13975 per cigarette Ontario tobacco tax  
**HST** = 13% tax applied to (\$0.1695 average 2015 cigarette price + \$0.13975 OT) = \$0.0402

**TT = \$0.18 per cigarette (\$0.2258 per gram)**

## 2015-16

**OT** = \$0.15475 per cigarette Ontario tobacco tax  
**HST** = 13% tax applied to (\$0.1699 average 2016 cigarette price + \$0.15475 OT) = \$0.00422

**TT = \$0.1969 per cigarette (\$0.2471 per gram)**

With the data above it is relatively straightforward to estimate the cost of tax evasion from recorded, on-reserve contraband allocation tobacco sales in Ontario.

## 2013-14

**C** = contraband tobacco sold on Ontario reserves  
**TT** = total tobacco tax per gram  
**E** = total tax evasion from tax-exempt contraband allocation tobacco on-reserve

**C \* TT = E**

**C** = 478 million grams are illegally sold as contraband (2013-14, using on-reserve population)  
**TT** = \$0.1991 per gram (2013-14)

**E = \$95.2 million per year lost in tax evasion from on-reserve contraband allocation tobacco (2013-14)**

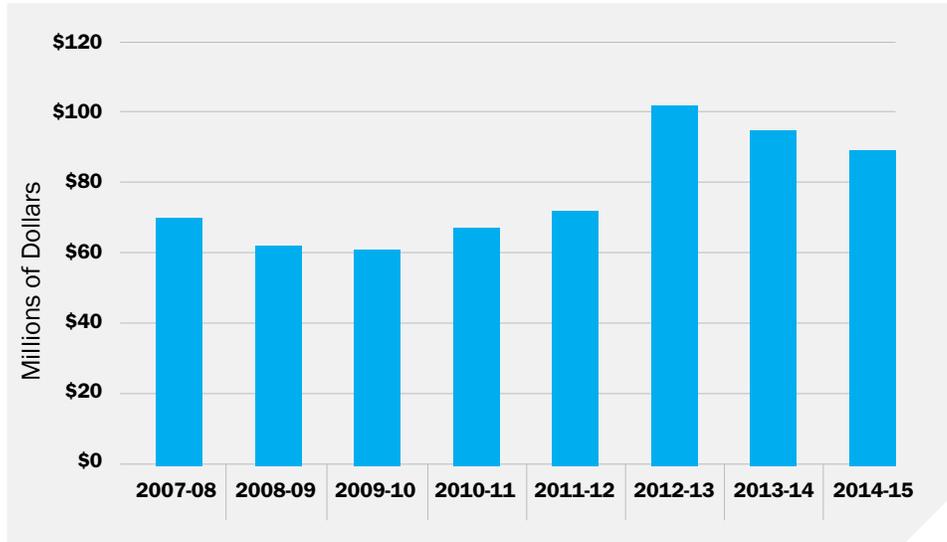
## 2014-15

**C** = 393 million grams are illegally sold as contraband (2014-15, using on-reserve population)

**TT = \$0.2258** per gram (2014-15)

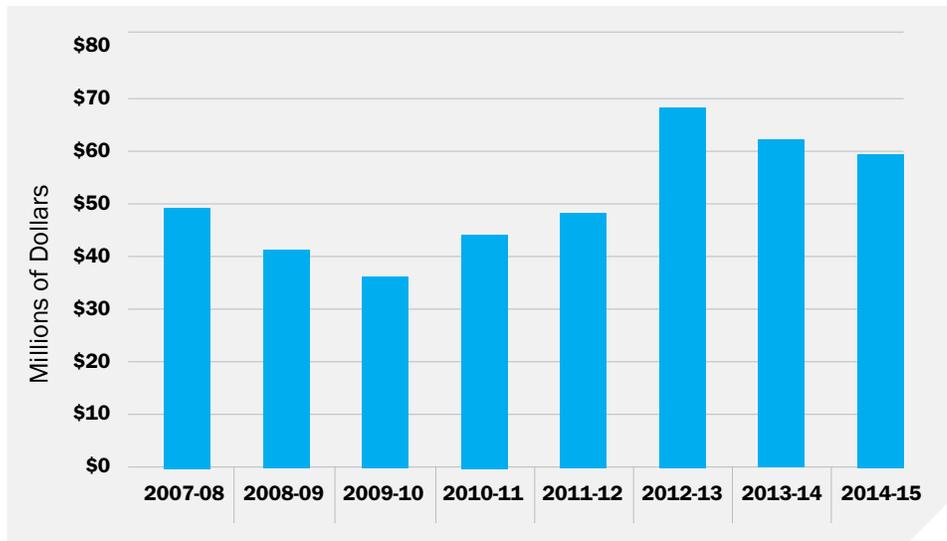
**E = \$88.7 million per year lost in tax evasion from on-reserve contraband allocation tobacco (2014-15)**

**Tax loss to both federal and Ontario governments from tax-exempt contraband tobacco sales on Ontario reserves, 2007-08 to 2014-15 (using on-reserve population)**



**Source:** Canadian Taxpayers Federation, 2016 with data from Ontario Ministry of Finance, 'Exempt Tobacco Sales on aboriginal reserves in Ontario, 2012-2014' released under the Freedom of Information (FOI) Act

**Tax loss to both federal and Ontario governments from tax-exempt contraband tobacco sales on Ontario reserves, 2007-08 to 2014-15 (using total Status Indian population over 15)**



**Source:** Canadian Taxpayers Federation, 2016 with data from Ontario Ministry of Finance, 'Exempt Tobacco Sales on aboriginal reserves in Ontario, 2012-2014' released under the Freedom of Information (FOI) Act

## Tax loss to both federal and Ontario governments from allocation tobacco sales on Ontario reserves, 2007-08 to 2013-14<sup>53</sup>

	2007-08		2008-09		2009-10		2010-11		2011-12		2012-13		2013-14		2014-15	
Millions of \$	Res.	Total Pop.	Res.	Total Pop.	Res.	Total Pop.	Res.	Total Pop.								
<b>Total</b>	\$88	\$88	\$81	\$81	\$81	\$81	\$86	\$86	\$91	\$91	\$127	\$127	\$122	\$122	\$125	\$125
<b>Legal</b>	\$18	\$40	\$18	\$40	\$21	\$45	\$19	\$42	\$20	\$43	\$25	\$59	\$27	\$60	\$36	\$66
<b>Contraband Allocation</b>	<b>\$70</b>	<b>\$49</b>	<b>\$62</b>	<b>\$41</b>	<b>\$60</b>	<b>\$36</b>	<b>\$67</b>	<b>\$44</b>	<b>\$72</b>	<b>\$48</b>	<b>\$102</b>	<b>\$68</b>	<b>\$95</b>	<b>\$62</b>	<b>\$89</b>	<b>\$59</b>

**CTF Finding:** Using the on-reserve population, the sale of tax-exempt contraband allocation tobacco on Ontario reserves has created an estimated tax hole to the federal government of \$617 million over the last eight years, averaging \$77.1 million per year and peaking at \$102 million in 2012-13.

Importantly, this does not include the lost tax revenue from the sale of non-allocation contraband tobacco sales.

Using the *total Status Indian population over 15* in these calculations, a tax hole of \$407 million has been created by the sale of contraband allocation tobacco over the last eight years, and \$59 million in 2014-15.

<sup>53</sup> Figures may not add up due to rounding

# VIII

## TOTAL TAX EVASION FROM CONTRABAND TOBACCO IN ONTARIO

### SCOPE OF THE CONTRABAND TOBACCO TRADE

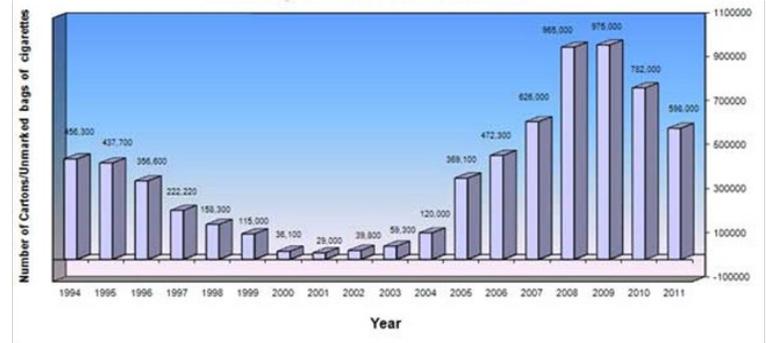
To this point, this report has examined only one element of the contraband tobacco trade, namely the cigarette allocation system and the amount of contraband contained within that one sphere of the overall contraband problem. As noted in the introduction, there are several other elements of contraband tobacco trade.

Assessing the size and scope of the overall contraband tobacco trade is a task dominated by estimates and proxies. One important, but incomplete proxy is the amount of contraband tobacco seized annually by authorities.

According to a 2011 report by the *Fraser Institute*, the volume of contraband tobacco seized in Canada increased significantly between 2001 and 2009.<sup>54</sup> In a 2009 study by the Canadian Tobacco Manufacturers Council estimated that 48.6% of cigarettes purchased in Ontario were illegal.<sup>55</sup>

In 2011, the most recent year reported, the RCMP seized approximately 598,000 cartons/unmarked bags of illegal cigarettes, 38,000 kilograms of fine cut tobacco, and 1.2 million illegal cigars, Canada-wide.<sup>56</sup>

### RCMP CIGARETTE SEISURES - 1994 TO 2011



Contraband tobacco is not just the dominion of smugglers and thieves, however, and it cannot be accurately estimated by the proxy of seizures.

The *National Coalition Against Contraband Tobacco* estimated in 2015 that one in three cigarettes was contraband.<sup>57</sup> In November 2014, 40% of cigarettes purchased within the most recent four weeks were contraband,<sup>58</sup> making Ontario ground zero for contraband tobacco.

<sup>54</sup> Gabler, Nachum. "Combating the Contraband Tobacco Trade in Canada." Fraser Institute. December 2011. <http://www.fraserinstitute.org/research-news/display.aspx?id=2147483963>

<sup>55</sup> Benzie, Robert and Brennan, Richard. "\$2 billion in tax revenue up in smoke." November 15, 2009. The Toronto Star. <http://www.thestar.com/news/investigations/article/726038--2-billion-in-tax-revenue-up-in-smoke>

<sup>56</sup> RCMP. 2011 Contraband Tobacco Statistics. <http://www.rcmp-grc.gc.ca/ce-da/tobac-tabac/stats-eng.htm>.

<sup>57</sup> National Coalition Against Contraband Tobacco, 'Illegal Cigarettes Remain the Defining Tobacco Control Problem in Ontario'. February 26, 2015. <http://stopcontrabandtobacco.ca/2015/02/illegal-cigarettes-remain-the-defining-tobacco-control-problem-in-ontario/?lang=fr>

<sup>58</sup> National Coalition Against Contraband Tobacco, 'Contraband Tobacco Monitoring Survey Results, October 2013 - October 2014'. November 28, 2014. [http://stopcontrabandtobacco.ca/wp-content/uploads/2012/02/NCACT\\_CONTRABANDMONITOR\\_2014-11\\_ONTARIO\\_ForPR.pdf](http://stopcontrabandtobacco.ca/wp-content/uploads/2012/02/NCACT_CONTRABANDMONITOR_2014-11_ONTARIO_ForPR.pdf)

## DETERMINING THE *TOTAL* TAX LOSS FROM CONTRABAND TOBACCO IN ONTARIO

Estimates of the total scope of the contraband tobacco trade in Ontario and Calgary vary. As previously noted, a 2009 study by the *Canadian Tobacco Manufacturers Council* estimated that 48.6% of cigarettes purchased in Ontario were illegal.<sup>59</sup> The *National Coalition Against Contraband Tobacco* estimated in 2015 that one in three cigarettes was contraband,<sup>60</sup> and in November 2014, 40% of cigarettes purchased within the most recent four weeks were contraband.<sup>61</sup>

This figures provide a range in which to estimate the *total* tax evasion from contraband tobacco in Ontario. Using a high estimate of 48.6% and a low of 33.3%, this report uses the formulas below to extrapolate the *total* cost of tobacco tax evasion in Ontario.

In the calculations on the amount of tax loss due to contraband within the cigarette allocation system on reserve, we removed the federal excise tax. Because allocation cigarette contraband is only a small portion of the overall contraband problem, we have added back in the federal excise tax as part of the total calculation in this section.<sup>62</sup>

**O** = total Ontario tobacco tax revenue  
**OT** = Ontario tobacco tax rate  
**AX** = approximate grams of tobacco sold in Ontario

**O / OT = AX**

### 2012-13

**O** = 1.14 billion (2013)  
**OT** = \$0.1235 per gram Ontario tobacco tax

**AX = 9.23 billion grams of tobacco sold in Ontario (estimate)**

**AX** = 9.23 billion grams of tobacco sold in Ontario  
**TT** = \$0.2595<sup>63</sup>  
**TR** = \$2.6 billion in federal and provincial total tobacco and sales tax revenue (estimate)  
**M1** = low estimated market share of contraband tobacco: 33.3%  
**M2** = high estimated market share of contraband tobacco: 48.6%

**TC = between \$858 million (low) and \$1.26 billion (high) in lost tax revenue in 2012-13 to the overall contraband tobacco trade in Ontario (estimate).**

### 2013-14

**O** = 1.1 billion (2014)  
**OT** = \$0.1235 per gram Ontario tobacco tax

**AX = 8.9 billion grams of tobacco sold in Ontario (estimate)**

**AX** = 8.9 billion grams of tobacco sold in Ontario  
**TT** = \$0.28165<sup>64</sup>  
**TR** = \$2.5 billion in federal and provincial total tobacco and sales tax revenue (estimate)  
**M1** = low estimated market share of contraband tobacco: 33.3%  
**M2** = high estimated market share of contraband tobacco: 48.6%

<sup>59</sup> Benzie, Robert and Brennan, Richard. "\$2 billion in tax revenue up in smoke." November 15, 2009. The Toronto Star. <http://www.thestar.com/news/investigations/article/726038--2-billion-in-tax-revenue-up-in-smoke>

<sup>60</sup> National Coalition Against Contraband Tobacco, 'Illegal Cigarettes Remain the Defining Tobacco Control Problem in Ontario'. February 26, 2015. <http://stopcontrabandtobacco.ca/2015/02/illegal-cigarettes-remain-the-defining-tobacco-control-problem-in-ontario/?lang=fr>

<sup>61</sup> National Coalition Against Contraband Tobacco, 'Contraband Tobacco Monitoring Survey Results, October 2013 - October 2014'. November 28, 2014. [http://stopcontrabandtobacco.ca/wp-content/uploads/2012/02/NCACT\\_CONTRABANDMONITOR\\_2014-11\\_ONTARIO\\_ForPR.pdf](http://stopcontrabandtobacco.ca/wp-content/uploads/2012/02/NCACT_CONTRABANDMONITOR_2014-11_ONTARIO_ForPR.pdf)

<sup>62</sup> For calculations showing the inclusion of the federal excise tax, see Appendix A.

<sup>63</sup> For calculations showing excise tax and HST see Appendix A

<sup>64</sup> For calculations showing excise tax and HST see Appendix A

**TC = between \$825 million (low) and \$1.22 billion (high) in lost tax revenue in 2013-14 to the overall contraband tobacco trade in Ontario (estimate).**

**2014-15**

**O** = 1.16 billion (2015)<sup>65</sup>

**OT** = \$0.13975 per gram Ontario tobacco tax

**AX** = 8.3 billion grams of tobacco sold in Ontario (estimate)

**AX** = approximate grams of tobacco sold in Ontario

**TT** = total tobacco taxes per gram(including sales taxes)

**TR** = total tobacco and sales tax revenue (federal and provincial) in Ontario

**M1** = low estimated market share of contraband tobacco in Ontario

**M2** = high estimated market share of contraband tobacco in Ontario

**TC** = total tax evasion from contraband tobacco in Ontario

**(AX \* TT = TR) \* M = TC**

**AX** = 8.3 billion grams of tobacco sold in Ontario

**TT** = \$0.3039<sup>66</sup>

**TR** = \$2.52 billion in federal and provincial total tobacco and sales tax revenue (estimate)

**M1** = low estimated market share of contraband tobacco: 33.3%

**M2** = high estimated market share of contraband tobacco: 48.6%

**TC = between \$832.6 million (low) and \$1.22 billion (high) in lost tax revenue in 2014-15 to the overall contraband tobacco trade in Ontario (estimate).**

**CTF Finding:** Using established estimates of the market share of the contraband tobacco trade in Ontario, this report estimates that between \$832.6 million and \$1.22 billion was lost in tax revenue to both the federal and Ontario governments in 2014-15.

<sup>65</sup> Public Accounts of Ontario, Volume 1 – Ministry Statements and Schedules, 2014-2015. [http://www.fin.gov.on.ca/en/budget/paccts/2015/15\\_vol1.pdf](http://www.fin.gov.on.ca/en/budget/paccts/2015/15_vol1.pdf)

<sup>66</sup> For calculations showing excise tax and HST see Appendix A

# IX

## PLAIN PACKAGING AND CONTRABAND TOBACCO

### WHAT IS PLAIN PACKAGING

In 2012, Australia mandated plain packaging for tobacco, which required the removal of all branding, colours, imaging, corporate logos and trademarks from tobacco packaging. Manufacturers are only permitted to print the brand name in a mandated size and font on the pack, in addition to health warnings.

Currently Australia is the only country mandating plain packaging, although the Singapore government recently announced a public consultation on the issue.<sup>67</sup> In Canada, public health officials developed proposals for plain packaging in 1994 and a parliamentary committee reviewed the issue and recommended further research.<sup>68</sup> The Liberal party also promised to force plain packaging in their 88-page campaign platform during the 2015 federal election.<sup>69</sup>

### PLAIN PACKAGING & SMOKING RATES

The purpose of plain packaging is to reduce smoking rates, but evidence from three years of plain packaging in Australia reveals that this policy is not effective.

While smoking in Australia has declined, the evidence shows that this decline is part of a long-term downward trend and is not necessarily correlated to the advent of

plain packaging. Further, since the implementation of plain packaging, the pace of the decline in smoking has in fact slowed.<sup>70</sup>

For adolescents, the data suggest that the rate of smoking has not declined since the introduction of plain packaging, but instead has increased from 2.5% to 3.4% between 2010 and 2013 for 12 to 17 year olds. Although this increase is not necessarily related to plain packaging, it clearly does not substantiate claims about the effect of plain packaging on reducing smoking rates among minors.<sup>71</sup>

### PLAIN PACKAGING AND CONTRABAND TOBACCO

Australia is faced with a contraband and counterfeit tobacco problem. Illegal tobacco in Australia is mainly brought into the country from overseas markets without the payment of excise duties. The illicit tobacco is sold at lower prices than Australian cigarettes, avoiding excise obligations. Like in Canada, illegal tobacco in Australia fuels organized crime.

A series of KPMG reports on contraband tobacco in Australia reveal that the size of the contraband market has grown since the introduction of plain packaging.

<sup>67</sup> Singapore Government Tobacco Public Consultation - <http://www.hpb.gov.sg/HOPFormWeb/getApp.do?appCode=71297&appName=Tobacco%20Public%20Consultation%20Dec%202015&tempId=Event&tempCode=20>

<sup>68</sup> Standing Committee on Health, House of Commons, May 4, 1994. <http://www.smoke-free.ca/plain-packaging/documents/1994/industryresponse-1994-canada/Smrm97c00-Hills.pdf>

<sup>69</sup> Globe and Mail, "Liberal pledge to demand plain cigarette packaging draws cheers", October 30, 2015. <http://www.theglobeandmail.com/news/politics/liberal-pledge-to-demand-plain-cigarette-packaging-draws-cheers/article27054353/>

<sup>70</sup> Institute for Policy Evaluation – Three Years of Plain Packaging for Tobacco Products in Australia, December 1, 2015. <http://www.ipe-saarland.de/app/download/10021513394/IPE+Study+3rd+Anniversary+PlainPackaging.pdf?t=1448906278>

<sup>71</sup> Institute for Policy Evaluation – Three Years of Plain Packaging for Tobacco Products in Australia, December 1, 2015. <http://www.ipe-saarland.de/app/download/10021513394/IPE+Study+3rd+Anniversary+PlainPackaging.pdf?t=1448906278>

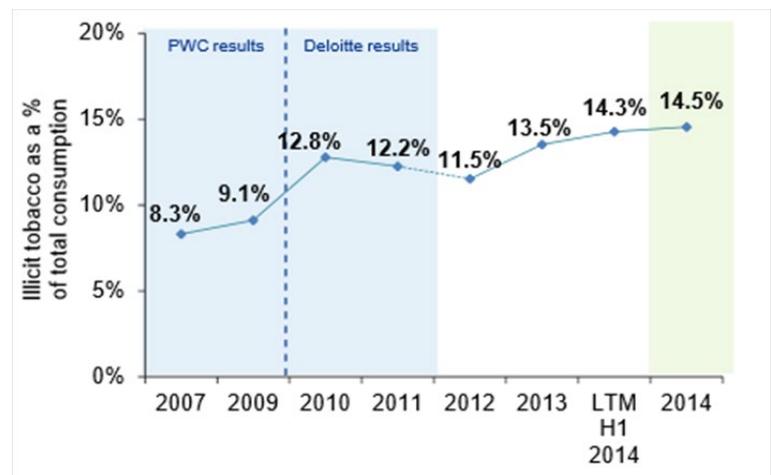
## CONSUMPTION OF ILLICIT TOBACCO IN AUSTRALIA BY CATEGORY AND AS A PERCENTAGE OF OVERALL CONSUMPTION, 2007-14<sup>72</sup>



KPMG found that in 2014, consumption of illicit tobacco in Australia was estimated to be 14.5% of total tobacco consumption, which is 1 percentage point higher than in 2013 and is the highest level of illicit consumption recorded.

## ILLICIT TOBACCO CONSUMPTION IN AUSTRALIA AS A PROPORTION OF TOTAL CONSUMPTION<sup>73</sup>

Plain packaging makes counterfeiting easier, and can fuel the contraband tobacco problem in Canada. Given the extent of the contraband problem in Canada, particularly in provinces like Ontario, and given that the data shows no link strong between plain packaging and smoking rates, Canada should think twice before implementing a plain packaging policy.



<sup>72</sup> KPMG – Illicit tobacco in Australia, 2014 Full Year Report, 30 March, 2015 - [http://www.pmi.com/eng/media\\_center/media\\_kit/Documents/KPMG%20Report%20FY%202014%20-%20Illicit%20tobacco%20in%20Australia.pdf](http://www.pmi.com/eng/media_center/media_kit/Documents/KPMG%20Report%20FY%202014%20-%20Illicit%20tobacco%20in%20Australia.pdf)

<sup>73</sup> KPMG – Illicit tobacco in Australia, 2014 Full Year Report, 30 March, 2015 - [http://www.pmi.com/eng/media\\_center/media\\_kit/Documents/KPMG%20Report%20FY%202014%20-%20Illicit%20tobacco%20in%20Australia.pdf](http://www.pmi.com/eng/media_center/media_kit/Documents/KPMG%20Report%20FY%202014%20-%20Illicit%20tobacco%20in%20Australia.pdf)

# X

## CONCLUSION AND RECOMMENDATIONS

Increased law enforcement by the authorities is a critical component of fighting the contraband tobacco trade in Canada, but even unlimited police resources will be unable to break the industry unless the fundamental incentives that create this black market are altered.

One of the simplest steps to fight contraband tobacco is to reduce the number of allocation cigarettes. As this report has made clear, unmarked allocation tobacco is being sold in large volumes to non-Status Indians. In 2014-15, between 47% and 72% of all reported sales of tax-exempt allocation tobacco on Ontario aboriginal reserves were made illegally to people who were not Status Indians. A generous reduction of the allocation amount would do much to reduce illegal sales. A simple first step would be to reduce the allocation amount by half, and then conduct a follow-up investigation, much like this one, to determine if further reductions are necessary.

This report and the CTF recognize that aboriginals have historic treaties signed in good faith with the Crown, which must be respected; nonetheless it is unacceptable that laws *intended* to maintain the sovereignty of aboriginals are abused by allowing Canadians without Indian Status to enjoy the fruits of such treaties. While many merchants dealing with contraband tobacco claim that their industry is legitimate because of the longstanding and historic aboriginal tobacco trade, they are in fact breaking treaties and the law.

Section 87 of the *Indian Act* and treaties granting tax-exempt status are clear that such status does not apply to Canadians who are not Status Indians doing business with them. By reinterpreting the law and treaties in such a fashion, illegal smoke shacks undercut law-abiding merchants, farmers and smokers, and they undermine anti-smoking initiatives and the rule of law itself.

# APPENDIX A

## CALCULATIONS INCLUDING FEDERAL EXCISE TAX

	2012-13	2013-14	2014-15	2015-16
<b>Average Pre-tax Price (PT)</b>	<b>\$0.1473 / cigarette</b> <b>(\$0.1848 / gram)</b>	<b>\$0.1474 / cigarette</b> <b>(\$0.1849 / gram)</b>	<b>\$0.1695 / cigarette</b> <b>(\$0.2126 / gram)</b>	<b>\$0.1699/cigarette</b> <b>(\$0.2132 / gram)</b>
<b>Applied Ontario Tobacco Tax (AOT)</b> AOT = Ontario tobacco tax + PT	<b>\$0.3083/ cigarette or gram</b> \$0.1235 + \$0.1848 = \$.3083 / cigarette	<b>\$0.3084/ cigarette or gram</b> \$0.1235 + \$0.1849 = \$0.3084/ gram	<b>\$0.35235/ cigarette or gram</b> \$0.13975 + \$0.2126 = \$0.35235 / gram	<b>\$0.36795 / cigarette or gram</b> \$0.15475 + \$0.2132 = \$0.35235 / gram
<b>Applied Federal Tobacco tax (FT)</b> Applied Federal Tobacco tax (FT)	<b>\$0.2698 / gram</b> \$0.085 + \$0.1848 = \$0.2698/ gram	<b>\$0.2901 / gram</b> \$0.10515 + \$0.1849 = \$0.2901/ gram	<b>\$0.31775 / gram</b> \$0.10515 + \$0.2126 = \$0.31775 / gram	<b>\$0.31835 / gram</b> \$0.10515 + \$0.2132 = \$0.31835 / gram
<b>Total Applied Tobacco Taxes (TAT)</b> TAT = AOT + FT + PT	<b>\$0.3933 / gram</b> \$0.1235 + \$0.085 + \$0.1848 = \$0.3933/ gram	<b>\$0.41355 / gram</b> \$0.1235 + \$0.10515 + \$0.1849 = \$0.41355 / gram	<b>\$0.4575 / gram</b> \$0.13975 + \$0.10515 + \$0.2126 = \$0.4575/ gram	<b>\$0.4731 / gram</b> \$0.15475+ \$0.10515 + \$0.2132 = \$0.4731/ gram
<b>Applied HST (HST)</b> HST = TAT * 13%	<b>\$0.053 / gram</b> \$0.3933 * 0.13 = \$0.051 / gram	<b>\$0.054 / gram</b> \$0.41355 * 0.13 = \$0.054 / gram	<b>\$0.059 / gram</b> \$0.4575 * 0.13 = \$0.059 / gram	<b>\$0.0615 / gram</b> \$0.4731 * 0.13 = \$0.059 / gram
<b>Total Taxes (TT)</b> TT = AOT + FT + HST	<b>\$0.2595 / gram</b> \$0.1235 + \$0.085 + \$0.051 = \$0.2595 / gram	<b>\$0.28165 / gram</b> \$0.1235 + \$0.10515 + \$0.053= \$0.28165 / gram	<b>\$0.3039 / gram</b> \$0.13975 + \$0.10515 + \$0.059= \$0.3039 / gram	<b>\$0.3214 / gram</b> \$0.15475 + \$0.10515 + \$0.0615 = \$0.3214 / gram
<b>Total Taxed Price (TTP)</b> TTP = TT + PT	<b>\$0.4443 / gram</b> \$0.2595 + \$0.1848 = \$0.4443 / gram	<b>\$0.46655 / gram</b> \$0.28165 + \$0.1849 = \$0.46655 / gram	<b>\$0.5165 / gram</b> \$0.3039 + \$0.2126 = \$0.5165 / gram	<b>\$0.5346 / gram</b> \$0.3214 + \$0.2132 = \$0.5346 / gram