Intelligence MEMOS

From: Ian Irvine

To: Canadians Concerned About Vaping

Date: March 8, 2023

Re: **Excise Taxes on Vaping Products: A grey forecast**

The power to tax tobacco in Canada is shared between federal and provincial governments. The federal government imposed an excise tax on e-cigarette liquid products in October of 2022. If the provinces match that – and Quebec has said it will – tax rates will become particularly high and likely give rise to unintended and adverse consequences.

Already, some provinces have specially elevated sales tax rates for "non-combustible nicotine products" or e-cigarettes, even though they generate just a small fraction of the toxins and carcinogens associated with traditional cigarettes. They are estimated to be 95 percent less risky if users switch completely, according to Public Health England. Hence, they are termed "reduced-risk" products and are even sold in some UK hospitals.

Here are some cases that illustrate how the tax works.

The federal tax is levied on the volume of liquid sold in a container. This starts at $5 on the first 10 millilitres and $1 on each additional 10 ml. Thus a 30 ml container of e-liquid carries a tax of $7 and a 120 ml container a tax of $16. Sales taxes are imposed on the final excise-inclusive price.

A 30 ml container that typically sells for $20 pre-tax will soon sell in Quebec for $39.10, while a 120 ml container typically selling for $45 pre-tax, will sell for $88.55, adding the provincial 15-percent sales tax. In these two examples, the effective tax rate will be close to 100 percent. A disposable e-cigarette containing 10 ml of e-liquid selling for $22 pre-tax, will cost $36.80, excise and sales taxes included, making for an effective tax rate of 67 percent.

Health Canada states that, if smokers completely move to vaping, they should

- immediately reduce their exposure to the harmful chemicals in smoking
- see general health improvements in the short term
- be more likely to quit smoking than those who use nicotine replacement therapy (NRT)
- save money in the long run.

The Quebec taxes are exorbitant in view of these statements.

Vape shops in Canada sell the lion's share of e-liquid and disposables as of early 2023. Gas and convenience stores specialize in the sale of pre-filled pods, though in recent months have begun to sell disposables. Vuse is the dominant supplier in these stores, with more than a 90 percent share. Juul is almost extinct in Canada.

I envisage a four-fold repercussion from these elevated taxes. The first is that fewer smokers will be enticed to switch to alternative lower-risk products. Most of the research based upon US data finds that consumers respond strongly to price incentives in this field. Some, though not all, research finds cross effects running from higher e-nicotine prices to more combustible purchases – meaning that fewer smokers transition to reduced-risk products in states where e-nicotine prices/taxes are high. The UK Royal College of Physicians advocates a simple 5-percent tax on e-nicotine products, recognizing their usefulness as a quit-smoking device.

The second concern with these elevated taxes is the high probability that Canada will develop both illegal and grey markets. Making e-liquid is not expensive. It requires knowledge, hygiene and safety. Three of the four ingredients (flavouring, propylene glycol and vegetable glycerine) are not subject to the excise taxes unless purchased in a vape shop. A litre of either glycol or glycerine purchased outside a vape shop costs roughly $23, including sales tax. Under double excise taxation, those carry a tax of $208 if sold in a vape shop.

As a result, we are already seeing changes in the retail marketplace. Some vendors who previously sold these ingredients in their vape shops are splitting their businesses in two, one offering purely nicotine-based e-liquid, and another for the other ingredients.

The do-it-yourself vaper, or the black-market manufacturer, then needs to buy just nicotine to manufacture e-juice, with almost tax-free ingredients. A black market is likely to establish itself quickly.

This diminishes tax revenue and undermines the social contract between governments and its citizens. Moreover, in this area, handling high-concentration nicotine is dangerous; it should be undertaken only by professionals in a secure environment. Nicotine is toxic beyond a threshold and just a small amount will burn skin.

Canada's combustible cigarette market has a 25-percent illegal component by volume. There is no reason to believe that the grey and black e-liquid market shares will be less.

The third fallout from punitive taxes is that law-abiding businesses will see a decline in demand. Some will go out of business, almost all will suffer a sizable drop in sales. Punitive taxes and a black market will see legal business suffer and employment decline.

Finally, since pre-filled pods and disposables are almost all imported, while e-liquid is almost all domestically manufactured, domestic products will carry a heavier tax burden than imported products.

The failure to set reasonable tax levels in this market arises because governments have not cooperated adequately; they have not been guided by the principle of risk-proportionate taxation; they have not been guided by research that points to substitutability; and, for whatever reason, have not been informed by lessons from the well-established decades-long illicit combustible cigarette trade.

Ian Irvine is a professor in Economics at Concordia University. He has worked as a consultant for the federal government on alcohol and tobacco and has recently worked for the Canadian Vaping Association. Some of his research has been funded by the Foundation for a Smoke Free World.

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