

Backgrounder

The Tobacco Manufacturers' Surtax 1994-2012

Impact of corporate income tax reductions and industry relocation.

The Tobacco Manufacturers Surtax (TMS) is a specific income tax levied on tobacco manufacturers. Originally imposed as a temporary surtax of 40% additional corporate income tax in 1994, the tax was made permanent and the rate was increased to 50% in 2001.^{1 2 3} This surtax is unique in Canada: similar taxes are not applied to other categories of manufacturers, and we do not know of similar tobacco tax profits in other countries. The highest level of tax revenue from this measure was reported by Finance Canada in 2001 at \$80 million.⁴

In the ten years since the tax was made permanent, a number of events have occurred which have significantly reduced the tax burden on tobacco manufacturers:

- At the time the tax was designed, virtually all cigarettes sold in Canada were manufactured in Canada. The “manufacturers’ tax” therefore captured most revenues from tobacco sales. In 2006, however, BAT relocated manufacturing to Mexico, which

meant it was no longer a ‘manufacturer’ within the meaning of the surtax.

BAT/Imperial Tobacco makes more than half the cigarettes smoked in Canada, and has historically been more profitable than the other companies.⁵

The relocation of manufacturing to Mexico reduces the income on which the tobacco manufacturers surtax is levied by more than a half.

- In the 2006⁶ and 2009⁷ budgets, the government reduced the general corporate income tax rate from 21% in 2007 to 15% in 2012.

The reduction in general corporate income tax rates reduces the federal tax rate for tobacco manufacturers by almost a third, from 31.5% in 2007 to 22.5% in 2012.

As a result of these two measures, **we estimate the tax on the profits from tobacco sales in Canada will fall by about 60% from 2005 to 2012, costing the federal treasury \$86 million in 2012.**

Figure 1: Estimates of Income Taxes on Tobacco Companies in Canada, 1994-2012 (\$millions)

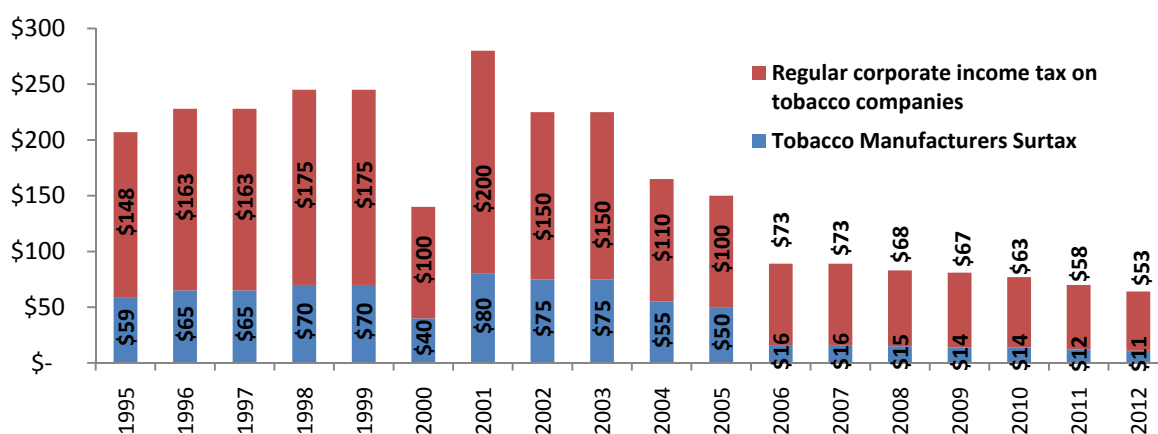


Table: Estimates of Income Taxes on Tobacco Companies in Canada, 1994-2001 (\$millions)

year	Tobacco Manufacturers Surtax revenues [1]	Total income tax from tobacco manufacturers [2]	Federal tax rate on tobacco manufacturers [3]	Estimated taxable corporate income from tobacco sales. (\$ millions) [4]	
				Manufactured in Canada	Manufactured outside Canada
1994	\$45		29.4%	\$536	
1995	\$59	\$207	29.4%	\$702	
1996	\$65	\$228	29.4%	\$774	
1997	\$65	\$228	29.4%	\$774	
1998	\$70	\$245	29.4%	\$833	
1999	\$70	\$245	29.4%	\$833	
2000	\$40	\$140	29.4%	\$476	
2001	\$80	\$280	31%	\$774	
2002	\$75	\$225	31%	\$726	
2003	\$75	\$225	31%	\$726	
2004	\$55	\$165	31%	\$532	
2005	\$50	\$150	31%	\$484	
2006	\$16	\$89	31%	\$150	\$350
2007	\$16	\$89	31%	\$150	\$350
2008	\$15	\$83	29.2%	\$150	\$350
2009	\$14	\$81	28.5%	\$150	\$350
2010	\$14	\$77	27%	\$150	\$350
2011	\$12	\$70	24.75%	\$150	\$350
2012	\$11	\$64	22.5%	\$150	\$350

Unshaded areas are figures reported by Finance Canada

Areas shaded in blue are calculated mathematically from figures reported by Finance Canada

Areas shaded in grey are estimated based on 2005 profitability continuing to 2012.

- [1] For 1994-2005, as reported by Finance Canada. For 2006 to 2012, calculated as 50% of the general corporate income tax as applied to profits from sales of tobacco products manufactured in Canada.
- [2] For 1995 – 2005, inferred from the Tobacco Manufacturers Sales tax at 40% (1995-2000) and 50% (2001 – 2005) of the general corporate income tax.
- [3] As reported in Finance Canada budgets.
- [4] For 1994-2005, inferred from Tobacco Manufacturers Surtax revenues. For 2006 to 2012, estimates based on 2005 profitability and historic profitability of BAT/Imperial Tobacco at 70% of corporate-wide income.

REFERENCES

- 1 See footnote 26 at Tax Expenditures and Evaluations 2005, Table 2.
http://www.fin.gc.ca/taxexp-depfisc/2005/taxexp05_3-eng.asp
- 2 See explanation of Surtax at page 89 of Finance Canada. Tax Expenditures: Notes to the Estimates.
http://www.fin.gc.ca/taxexp-depfisc/2010/TEE10Notes_eng.pdf
- 3 Income Tax Act (1985, c. 1). Part II
http://laws.justice.gc.ca/eng/l-3.3/page-4.html#anchorbo-ga:l_II
- 4 Finance Canada, Tax Expenditures and Evaluations, 2008
- 5 Physicians for a Smoke-Free Canada. Cigarette Industry Revenues in Canada. 1991-2003
<http://www.smoke-free.ca/factsheets/pdf/earnings.pdf>
- 6 Finance Canada. Budget 2006. Tax Measures. Supplementary Information.
- 7 Finance Canada. Budget 2009. Chapter 3. Highlights.

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