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February 18, 2011

The Honourable Jim Flaherty
Minister of Finance
House of Commons
Ottawa, Ontario
K1A 0A6

Dear Minister:

This letter is to request your review of the Tobacco Manufacturers' Surtax, and your action to update this important measure and to restore it to its original purpose.

I attach a fact sheet which illustrates how this federal tool which is properly used to reclaim from the tobacco industry some of the costs associated with its operation has become less effective as a result of (a) the relocation of manufacturing by the largest manufacturer to Mexico and (b) the cuts to general corporate income tax rate, on which the surtax is based.

You will note that our estimates show that the revenues received from tobacco companies through this tax will fall from \$50 million in 2005 to \$12 million this year.

I suggest that two relatively simple amendments could be included in this year's budget bill:

- The adoption of the definition of tobacco manufacturer that is used in the federal Tobacco Act, i.e.
"manufacturer", in respect of tobacco products, includes any entity that is associated with a manufacturer, including an entity that controls or is controlled by the manufacturer or that is controlled by the same entity that controls the manufacturer.
- An increase in the Surtax rate from 50% to 100%. This will restore the corporate income tax on tobacco manufacturers to 30%, roughly the same as when the tax was made introduced in 1994 and made permanent in 2001.

Such an approach, I believe, is in keeping with your decision to not apply general reductions in the GST to tobacco products and to increase other taxes in a compensatory way to ensure that the tax burden on tobacco products remained the same.

With best wishes

Cynthia Callard
Executive Director

Encl:

- *Fact sheet: The Tobacco Manufacturers' Surtax 1994-2012
Impact of corporate income tax deductions and industry relocation*
- *Extract from Income Tax Act*

c.c.

- *The Honourable Leona Aglukkaq, Minister of Health*
- *Members of the House of Commons Standing Committee on Health.*
- *Members of the House of Commons Standing Committee on Finance.*

Extract from:

Income Tax Act (1985, c. 1)

PART II. TOBACCO MANUFACTURERS' SURTAX¹

Surtax

182. (1) Every corporation shall pay a tax under this Part for each taxation year equal to 50% of the corporation's Part I tax on tobacco manufacturing profits for the year.

Definitions

(2) In this Part,

"exempt activity"

"exempt activity", of a particular corporation, means

(a) farming; or

(b) processing leaf tobacco, if

(i) that processing is done by, and is the principal business of, the particular corporation,

(ii) the particular corporation does not manufacture any tobacco product, and

(iii) the particular corporation is not related to any other corporation that carries on tobacco manufacturing (determined, in respect of the other corporation, as if the particular corporation did not exist and the definition "tobacco manufacturing" were read without reference to the words "in Canada");

"Part I tax on tobacco manufacturing profits"

"Part I tax on tobacco manufacturing profits" of a corporation for a taxation year means 21% of the amount determined by the formula

$$(A \times B/C) - D$$

where

A is the amount that would be the corporation's Canadian manufacturing and processing profits for the year, within the meaning assigned by subsection 125.1(3), if the total of all amounts, each of which is the corporation's loss for the year from an active business, other than tobacco manufacturing, carried on by it in Canada, were equal to the lesser of

(a) that total otherwise determined, and

(b) the total of all amounts, each of which is the amount of the corporation's income for the year from an active business, other than tobacco manufacturing, carried on by it in Canada,

B is the corporation's tobacco manufacturing capital and labour cost for the year,

C is the total of the corporation's cost of manufacturing and processing capital for the year and its cost of manufacturing and processing labour for the year, within the meanings assigned by regulations made for the purposes of section 125.1, and

D is

(a) where the corporation is a Canadian-controlled private corporation throughout the year, the corporation's business limit for the year as determined for the purpose of section 125, and

(b) in any other case, nil;

“tobacco manufacturing”

“tobacco manufacturing” means any activity, other than an exempt activity, relating to the manufacture or processing in Canada of tobacco or tobacco products in or into any form that is, or would after any further activity become, suitable for smoking;

“tobacco manufacturing capital and labour cost”

“tobacco manufacturing capital and labour cost” of a corporation for a taxation year means the total of the amounts that would be the corporation’s cost of manufacturing and processing capital for the year and its cost of manufacturing and processing labour for the year, within the meanings assigned by regulations made for the purpose of section 125.1, if the manufacturing or processing referred to in the definition “qualified activities” in those regulations were tobacco manufacturing.

NOTE: Application provisions are not included in the consolidated text; see relevant amending Acts. 1994, c. 29, s. 16; 1997, c. 26, s. 77; 2000, c. 30, s. 173; 2001, c. 16, s. 43; 2007, c. 35, s. 54.

Return

183. (1) Every corporation that is liable to pay tax under this Part for a taxation year shall file with the Minister a return for the year in prescribed form not later than the day on or before which the corporation is required by section 150 to file its return of income for the year under Part I.

Payment

(2) Every corporation shall pay to the Receiver General on or before its balance-due day for each taxation year its tax payable under this Part for the year.

Provisions applicable

(3) Subsections 150(2) and 150(3), sections 151, 152, 158 and 159, subsections 161(1) and 161(11), sections 162 to 167 and Division J of Part I apply to this Part with such modifications as the circumstances require.

ⁱ Income Tax Act (1985, c. 1). Part II
http://laws.justice.gc.ca/eng/l-3.3/page-4.html#anchorbo-ga:l_II