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Optimal Taxation, the Underground Economy and Government Policy: Recommendations for Tobacco, Vaping, Marijuana and Gaming

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Optimal Taxation, the Underground Economy and Government Policy: Recommendations for Tobacco, Vaping, Marijuana and Gaming[1]

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Executive Summary

This study investigates optimal taxation policies for tobacco, vaping, cannabis and online gaming that are, for the most part, considered “sin goods” and are traditional sources of government revenue, both at the provincial and federal levels. It arrives at the following recommendations:

Tobacco

- Reducing the price differential between legal and illegal products is critical to stimulate relatively greater demand for legal tobacco and possibly increase tax revenues. Federal and provincial governments should carefully evaluate the magnitude of illegal markets before setting tobacco taxes and determine whether such tax increases have the potential to increase contraband activity. Given the magnitude of the underground economy, the involvement of organized crime, and money-laundering activities, assessing the growth potential of illegal markets from tax increase should be as important as government revenue generation.

- Federal and provincial governments should consider implementing policy mechanisms that help coordinate setting of tobacco taxes that would help ensure stable revenues as well as minimize the growth of the underground economy.

- Policymakers must work in collaboration and partnership with First Nations to implement tobacco taxes on reserves. They should explore taxation possibilities that, while respectful of the rights of First Nations, decrease the likelihood of underground and criminal activity that negatively affects both non-Indigenous communities and First Nations communities.

    - For example, policymakers should explore with First Nations the possibility of implementing lower tobacco taxes than those implemented by the province. This would still maintain a price differential relative to off-reserve cigarettes, which might benefit certain community members. Retailers would collect the tax revenue and remit it directly to local reserve governments, which could then allocate the funds to, for example, community development, infrastructure and job creation. In this respect, provincial taxes are the policy lever, as federal taxes are imposed on production while provincial tobacco taxes are collected by retailers.

- Federal and provincial governments must adopt stricter enforcement measures to curb the underground market and especially learn from strategies employed by Quebec.

- Federal and provincial governments must spend resources to accurately define the magnitude of illegal markets, which would then lead to efficient policy decisions on tobacco taxation.

- Federal and provincial governments should invest in campaigns that raise awareness that consuming illicit tobacco is illegal and encourages the growth of organized crime involvement.

Vaping

- From a broader perspective, there should be greater movement toward strategies that facilitate and acknowledge that vaping can be an effective mechanism for harm reduction and an effective strategy for smoking cessation. Public health agencies in Canada should take a close look at the success of vaping in this respect, as reported by Public Health England.

- The federal government should not impose any further taxes on e-liquid as long as contraband tobacco is easily accessible. In a similar vein, if provinces impose their own excise taxes on e-liquid, they should be lower than corresponding federal excise taxes, and should also not lead to significant price increases for e-liquid.

- Resources should be invested to reduce the attractiveness of vaping to teens. As is the case in the U.K., sale of vaping products to individuals aged under 18 should be prohibited. Age checks must be enforced at points of sale, with fines imposed on retailers who sell to minors without age checks as well as on minors who purchase/possess vaping products.

    - Further, advertising that glamorizes vaping should not be permitted, and governments might consider social media campaigns with popular influencers to highlight the dangers of nicotine consumption and addiction from vaping. Flavours that are obviously attractive to teens — such as bubble gum or other candy-related options — should not be permitted. Federal and provincial governments should invest in campaigns that raise awareness that consuming illicit tobacco is illegal and encourages the growth of organized crime involvement.

Cannabis

- There should be a reduction in federal and provincial taxes on cannabis products as well as a harmonization of tax rates across provinces. Alberta, Ontario and Saskatchewan should either eliminate or significantly reduce their specific ad valorem sales adjustment taxes. A possible strategy would be to reduce excise taxes to the higher of $0.75 per gram, or 7.5% of a producer's selling price to reduce price differentials between legal and illegal alternatives to dried/fresh cannabis.

- Federal and provincial governments should also consider reducing taxation of Cannabis 2.0 products, which is consistent with harm reduction principles. A possible step would be to reduce the total tax rate to $0.0075/mg of total THC.

- Significant resources should be spent on social media public awareness campaigns on the health risks and danger of purchasing contraband cannabis products, especially to target youth. Similarly, there should be social media campaigns to educate users on the harm reduction benefits of non-combustible cannabis products/cannabis. There should be specific budgeting that provides resources to enforcement agencies to combat the spread of illicit cannabis, in tandem with measures allocated to eradicate underground markets for tobacco and vaping products.

Online gaming

- Winnings from online gaming are largely exempt from taxation in Canada, which is not the case in the United States. Retaining this feature is critical to ensure the attractiveness of provincial markets to Canadian residents. Further, provincial markups on suppliers of online gaming and corporate taxes should be set while keeping in mind corresponding taxes in other jurisdictions. This will attract more suppliers to provincial markets, which will lead to more diversity in gaming options and reduce the likelihood of consumers choosing underground or grey market alternatives.

- Ensuring diversity in online gaming options is also important given the focus on sports betting in the United States and the need for Canadian markets to be competitive. Further, the availability of legal online gaming can be a deterrent to the presence of organized crime and money laundering. The Cullen Commission Report (2022) notes gambling as a strong means for money laundering in British Columbia.

I. Introduction

High taxation of sin commodities is primarily driven by three ideas: first, higher taxes are a mechanism to increase prices paid for goods that are harmful to health and can therefore reduce negative externalities by incentivizing reduced consumption. Second, and on a related point, higher taxes on goods that are harmful to health can be justified in that consumers should bear future costs in government healthcare expenditures associated with treatment costs. Third, the demand for such goods is usually quite price inelastic, which means that consumption remains relatively unchanged even with substantial price increases. The implication is that higher taxes on sin commodities will not result in significant reductions in demand, and therefore result in potentially higher tax revenues. Understanding the revenue potential of different taxes is of key relevance to policymakers, especially during an era of mammoth public debt because of the COVID-19 pandemic.

Peer-reviewed academic research has clearly proven that high tobacco taxes have been instrumental in reducing smoking and deaths from associated diseases. However, while higher taxes can be used as a corrective mechanism to reduce negative externalities from the perspective of individual health, such policies ignore the possibility that high taxes also have the potential to result in significant underground economies. Contraband products are more likely to be harmful to individual health, result in a significant loss in government tax revenue and also encourage criminal activities around the trafficking of illegal goods. Enforcement agencies in Canada have confirmed the involvement of criminal organizations in the sale of contraband tobacco.[2] Revenues from contraband tobacco could potentially be used by organized crime to fund human trafficking, money laundering and drug trades.[3] The Cullen Commission Report (2022), which looked at the prevalence of money laundering in British Columbia, identifies contraband tobacco as one of the top nine money laundering risks and a source of revenue for organized crime.

It is also important to consider the impacts of harm reduction. For example, taxation on vaping alternatives should be lower relative to tobacco products, which would incentivize smoking cessation. The United Kingdom National Health Service (NHS) and Public Health England (PHE) have strongly advocated the use of e-cigarettes and vaping alternatives, along with counselling, as means to reduce smoking by adults.[4] According to a study commissioned by PHE, in 2017

[2] For example, please see https://www.rcmp-grc.gc.ca/ce-da/tobac-tabac/index-eng.htm, last accessed September 10, 2022, and https://www.rcmp-grc.gc.ca/en/news/2022/rcmp-fsoc-contraband-tobacco-investigation-leads-seizure-7500-cartons-and-charges-two-men, accessed October 1, 2022.

[3] Please refer to https://www.thespec.com/news/hamilton-region/2022/06/01/contraband-tobacco-illegal-cigarettes.html, last accessed September 8, 2022, and https://www.ctvnews.ca/w5/organized-crime-behind-contraband-tobacco-costs-governments-billions-1.3864360, accessed October 1, 2022.

[4] https://www.nhs.uk/live-well/quit-smoking/using-e-cigarettes-to-stop-smoking and https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/733022/Ecigarettes_an_evidence_update_A_report_commissioned_by_Public_Health_England_FINAL.pdf. Accessed September 8, 2022. Based on a comprehensive review of the literature, another recent study finds smokers who switched to vaping would experience a "substantial reduction" in their exposure to toxic substances that cause cancer and lung and cardiovascular disease. The study also notes the importance of ensuring that non-smokers not

more than 50,000 smokers — who otherwise would have continued to smoke — stopped smoking with assistance from a vaping product.[5] This approach is coupled with initiatives aimed at deterring youth vaping. Specifically, selling vaping products to anyone aged under 18 and buying vaping products for anyone under 18 are prohibited.

The principle of harm reduction is also relevant to online gaming and cannabis consumption, as it implies that taxation policies should be harmonized across provinces and at a level that reduces the attractiveness of unregulated options. With respect to cannabis, reducing underground alternatives further implies that consumers should have easy access to legal and safe products given the ease in procuring illegal supply through apps.

Most studies investigate the effects of commodity taxation by focusing on demand responses and negative externality implications for the specific good. Optimal taxation necessitates not only understanding the impacts of higher taxes on demand and externality effects for a specific good, but also accounting for how higher taxes can affect the demand for other similar goods. In economics, this is known as the Theory of Second Best. For example, while higher commodity taxes might reduce the consumption of vaping goods, besides creating a flourishing underground economy such a policy would also reduce the price differential between tobacco and vaping products. This would lead to a lower likelihood of individuals willing to attempt smoking cessation by switching to nicotine-free vaping products and thus be contrary to harm reduction.

It is also important to acknowledge that underground markets may exist independent of price differentials between legal and illegal substitutes — for example, when consumer access to products is restricted, as was the case for some provinces when marijuana was legalized in the country. Restrictions in the number of stores and allocation of store permits through an odd lottery system (in Ontario) actually led to the growth of the underground economy in cannabis, which has continued unabated.

A final “sin good” that is examined in this study is online gaming. Ontario became the first province to launch a legal online gaming market in Canada to reduce consumer use of unregulated and illegal alternatives. The launch of such a market is extremely important from a harm reduction perspective, as it enables the implementation of features that address issues related to problem gambling. Further, legal online gaming also has significant tax revenue potential for provincial governments. For tax revenues to be fully harmonized, provincial governments should ensure that taxes on winnings, as well as on earnings of participating firms, are competitive with other international markets in the United States and Europe.

initiate the use of vaping products. Please see https://www.theguardian.com/society/2022/sep/29/switch-from-smoking-to-vaping-cuts-health-risks-substantially-report-finds, last accessed October 30, 2022.

[5] See https://www.gov.uk/government/publications/vaping-in-england-evidence-update-february-2021/vaping-in-england-2021-evidence-update-summary#:~:text=Studies%20show%20that%20tens%20of,for%20smoking%20cessation%20and%20reduction, last accessed September 10, 2022.

The existence of underground markets in Canada is not a novel concept. However, recent and contemporary events as well as technological evolutions have resulted in conditions that are particularly catalytic for their growth. First, there is a significant need for increased government revenues from higher taxes. Second, extraordinarily high inflation rates have squeezed the household budgets of many Canadians, increasing the attractiveness of underground alternatives over legal goods.[6] Third, the devastating economic consequences of COVID-19 have enhanced the attractiveness of engaging in illegal market activities. There is recent peer-reviewed research to support this possibility. Using data from 125 countries from 1995–2017, Berdiev et al. (2021) found that epidemics are correlated with a growth of the underground economy, as traditional sources for goods become more difficult to access and enforcement resources are directed to other needs during epidemics. Fourth, the ease of locating cheaper illegal sources for certain products through apps has considerably reduced search costs for consumers and increased interest in underground alternatives.

II. Contraband Tobacco

Increasing tobacco taxes, and cigarette taxes in particular, has been a favoured policy lever used by both federal and provincial governments to increase tax revenues. Further, there is strong empirical evidence that the significant increase in Canadian tobacco taxes since the late 1990s has been a key factor behind the significant reductions in smokers that occurred over the same time period, especially among youth.[7] From an international perspective, there is a consensus that higher cigarette prices through increases in taxes are the most effective means to curb smoking and reduce deaths from tobacco-related diseases.[8] However, persistent increases in taxations make contraband tobacco an attractive substitute to smokers, hence a significant price differential between legal and illegal tobacco driven by high taxation levels incentivizes the growth of an underground economy.[9] As discussed earlier, perhaps the more important point is that the lucrative returns available from contraband tobacco have led to the involvement of organized crime gangs. The Cullen Commission Report (2022) notes contraband tobacco as an important source of money laundering in British Columbia.

In addition to significant price differentials between legal and illegal tobacco, there are other factors that are essential to a successful and thriving contraband tobacco market.[10] These include but are not restricted to: 1) ease of access to purchasers, 2) a low probability of purchasers being apprehended by police and 3) a low probability of illegal sources of supply being eliminated by enforcement agencies. There is some research that suggests the above conditions exist in part because of the availability of contraband tobacco from First Nations reserves. For example, a

[6] Employing data from 153 developed and developing countries over the 1999–2007 period, Mazhar and Méon (2017) found evidence of a positive correlation between inflation and the growth of shadow or underground economies.
[7] For example, see Irvine and Gospodinov (2009).
[8] Jha and Peto (2014). Jha et al. (2020).
[9] For an elegant theoretical exposition of the choices facing consumers, producers and governments in the face of significant contraband tobacco, please refer to Irvine and Sims (2014).
[10] A recent news article suggests that while a legal pack of cigarettes costs between $14 and $17, an illegal pack can be obtained for as little as $4. https://www.thespec.com/news/hamilton-region/2022/06/01/contraband-tobacco-illegal-cigarettes.html, last accessed October 30, 2022.

study by the Non-Smokers' Rights Association (2009) discusses how smokers can purchase contraband cigarettes from smoke shacks on First Nations reserves or through other, off-reserve illegal networks. The supply for contraband tobacco comes from illicit manufacturing operations in First Nations reserves in Canada and the United States, Canadian brand-name cigarettes intended for reserves but made generally available and sold without applicable provincial tobacco taxes paid, and cigarettes stolen from convenience stores and truck shipments.

A more recent study by EY (2020) also points to the significant amount of illegal selling that occurs on First Nations reserves, specifically those located in Ontario and Quebec. Most manufacturing occurs in the two reserves of the Six Nations in Southwestern Ontario and Kahnawake in Quebec. The contraband is then distributed to other reserves and provinces through a network of sellers, including organized criminal gangs.

Press releases by police agencies indicate that smuggling of contraband tobacco is not trivial.[11] For example, a CTV news report suggests that illegal tobacco costs the Ontario government around a billion dollars of lost tax revenues, and between $2–$3 billion for other provinces and the federal government. Also important to consider are the negative effects of organized crime activities on communities in First Nations reserves.

With respect to academic research, Zhang and Schwartz (2015) employed data from the 2008–2012 waves of the Canadian Tobacco Use Monitoring Survey (CTUMS) to estimate use of smuggled or contraband cigarettes among Ontario smokers. Their research suggests a declining trend in contraband use over the time period of their study. However, relying on self-reported use of contraband product may lead to estimates that are biased downwards. Other recent studies have established that the size of the contraband tobacco market in Canada has been large and resulted in significant losses in government tax revenues. The lack of official data has resulted in innovative means to quantify the magnitude of contraband tobacco. For example, Van Geyn (2016) calculates the amount of illegal tobacco by estimating the amount of tax-exempt tobacco allocated on Ontario First Nations reserves that is eventually sold illegally to people who were not band members. The amount of tobacco multiplied by appropriate tobacco tax rates results in an estimate of between $832.6 million and $1.22 billion in lost federal and provincial tax revenue in 2014–2015.

Sen (2017) employs econometric methods to estimate the amount of smuggled cigarette cartons, along with associated lost tax revenues, from 2006–2014 in Quebec and Ontario. Data for provinces that did not experience significant smuggling (Alberta, Manitoba and Saskatchewan) from 1996–2014 are pooled along with data for Ontario and Quebec for years when smuggling

[11] As noted by Sen (2017), press releases by the Royal Canadian Mounted Police (RCMP) also suggest the seizure of significant amounts of contraband tobacco entering through the Central St. Lawrence Valley Corridor. The RCMP has organized a Combined Forces Special Enforcement Unit Contraband Tobacco Initiative aimed at coordinating federal, provincial and municipal law-enforcement agencies to target organized crime involved in contraband tobacco smuggling. Please see https://www.newswire.ca/news-releases/crtf-seizes-two-tons-of-contraband-tobacco-in-two-weeks-589074391.html and "Illicit Tobacco," available at http://www.rcmp-grc.gc.ca/ce-da/tobac-tabac/index-eng.htm for more detail.

did not reach serious levels (1996–2005) in these provinces. This pool of data is then used to estimate the relationship between legal cigarette sales (per capita of population aged 15 and older) and the impacts of various determinants of legal sales of cigarettes.[12] The resulting econometric model can then be used to predict the number of per capita sales that should take place in the absence of smuggling. The difference between the predictions and actual legal sales yields estimates of the number of legal cigarettes that are displaced by illegal supply.

The results of this research suggest the presence of a significant underground market for cigarettes in Ontario. Specifically, in 2014, Ontario lost tax revenue of approximately $816–$900 million. In contrast, lost tax revenue from illegal contraband is much lower in Quebec, relative to Ontario, at approximately a tenth of corresponding amounts in Ontario. According to Sen (2017), the significant decline in illegal sales in Quebec can be at least partially attributed to additional federal and provincial resources devoted to law enforcement.

A recent study by EY also proposes an innovative method to quantify the magnitude of illegal supply. Specifically, the paper took advantage of the temporary shutdown of First Nations tobacco manufacturing and sales operations in Ontario and Quebec during the peak of the first wave of COVID-19 (May 2020 to June 2020) to evaluate the extent of the illegal cigarette market in Canada. The study found that legal sales increased by 24% in June 2020 relative to June 2019. While other factors may have contributed to this rise in legal sales, the analysis done in this research suggests otherwise. The study examined cigarette sales in a sample of convenience stores and found the legal sales of cigarettes in the month of June increased by 44.9% in New Brunswick, 47% in Prince Edward Island and 44.3% in Newfoundland and Labrador compared to sales in June 2019.

In summary, the above discussion suggests the existence of a significant underground economy for tobacco in different parts of Canada, particularly in Ontario. Results from Sen (2017) indicate that estimated illegal supply as a proportion of all carton sales in Ontario dropped from about 35%–38% in 2008 to roughly 20%–23% in 2014. The corresponding decline for Quebec was even more pronounced, from approximately 31%–34% in 2008 to roughly 4%–5% in 2014. However, results from the EY study indicate that contraband tobacco remains a significant proportion of total cigarette consumption. This is unsurprising given significant increases in relevant prices and excise taxes over the past few years. Table 1 below documents average carton (200 cigarettes) prices across provinces for 2017 and 2022.[13]

[12] Explanatory variables are the consumer price index for cigarettes, the province-specific unemployment rate for individuals aged 15 and older, the percentage of economic families living below the province's low-income cut off (LICO), a trend variable, the number of police officers per 100,000 of population and province-specific dummy variables.

[13] See https://www.smoke-free.ca/SUAP/2020/taxrates.pdf and https://depquebec.com/wp-content/uploads/2018/03/Cig-Prices-July-2017.pdf

Table 1. Average Carton Prices (200 Cigarettes), 2017 and 2022

Province	July 2017	August 2022	Price Increase (%)
British Columbia	106.59	143.4	34.53
Alberta	116.13	132.9	14.44
Saskatchewan	128.8	145	12.58
Manitoba	137.24	147.4	7.4
Ontario	102.4	122.6	19.73
Quebec	93.95	106.5	13.36
New Brunswick	116.13	141	21.42
Prince Edward Island	130.9	150.2	14.74
Nova Scotia	129.85	150.2	15.67
Newfoundland and Labrador	122.46	157.1	28.29

British Columbia, Newfoundland and Labrador, New Brunswick and Ontario had the steepest price increases over the sample period, ranging from roughly 20%–35%. The other provinces experienced price increases from approximately 7% (Manitoba) to roughly 16% (Nova Scotia). Corresponding figures on federal and provincial excise taxes and duties in Table 2 suggest that much of the increase in prices can be attributed to taxes. The Federal Excise Tax rose by roughly 39%, with large increases (18%–36%) in provincial excise taxes in British Columbia, Alberta, Prince Edward Island and Newfoundland and Labrador. The provincial excise tax in Ontario has been slightly less at roughly 12%.

Table 2. Federal and Provincial Duties and Excise Taxes on Cartons (200 Cigarettes), 2017 and 2022

	Federal Excise Tax 2017	Federal Excise Tax 2022	Provincial Excise Tax 2017	Provincial Excise Tax 2022	Provincial Excise Tax In-crease (%)
British Columbia	21.56	29.79	47.8	65	35.98
Alberta	21.56	29.79	50	59	18
Saskatchewan	21.56	29.79	54	54	0
Manitoba	21.56	29.79	59	60	1.7

	Federal Excise Tax 2017	Federal Excise Tax 2022	Provincial Excise Tax 2017	Provincial Excise Tax 2022	Provincial Excise Tax In-crease (%)
Ontario	21.56	29.79	32.96	36.95	12.11
Quebec	21.56	29.79	29.8	29.8	0
New Brunswick	21.56	29.79	51.04	51.04	0
Prince Edward Island	21.56	29.79	50	59.04	18.08
Nova Scotia	21.56	29.79	55.04	59.04	7.27
Newfoundland and Labrador	21.56	29.79	49	65	32.65

In 2017, total federal and provincial excise taxes on a carton of 200 cigarettes in Ontario and Quebec were $54 and $52, respectively. By August 2022, the rates for Ontario and Quebec had climbed to roughly $66.74 and $60. However, provincial excise taxes are considerably higher in other provinces. Deducting the approximate $30 Federal Excise Tax, Ontario and Quebec currently have the lowest provincial excise taxes at roughly $37 and $30. All other provinces have excise taxation levels from $50–$65 per carton. For all provinces, provincial and federal excise taxes are a significant portion of final carton price, ranging from 55%–66%. Such high rates facilitate the existence of an underground economy, especially if contraband products are easily available from First Nations reserves. Besides health risks associated with consuming unregulated products, the existence of significant profit opportunities encourages the entry of organized crime networks.[14] The pronounced increase in legal cigarette sales found by the EY study is consistent with significant levels of provincial excise taxes in Atlantic Canada. There is also evidence that the significant increases of cigarette taxes in Newfoundland and Labrador have coincided with the growth of underground alternatives.[15]

The figures that follow show trends in provincial revenues from tobacco taxes and provincial excise taxes from 2009–2019. There are trends that are suggestive of a relationship between higher excise taxes and reduced revenues. First, excise taxes rose in all provinces over the sample period. Second, for most provinces, there was a declining trend in provincial tax revenues sometime during the middle or latter half of the sample period. These movements are consistent with the occurrence of large-scale smuggling as a result of higher cigarette taxes, eventually leading to reductions in tax revenues.

[14] Please see Nachum and Gambler (2010) and Leuprecht (2016) for further details.
[15] For example, please see https://www.cbc.ca/news/canada/newfoundland-labrador/contraband-cigarettes-newfoundland-1.6322711, accessed October 1, 2022.

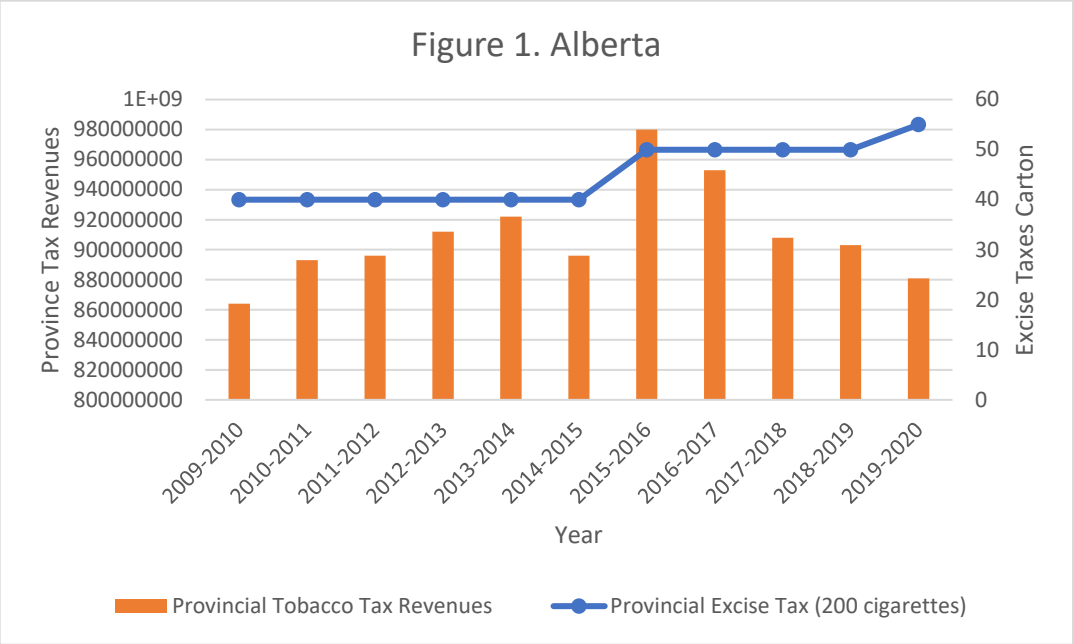
Figure 1. Alberta
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Province Tax Revenues
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Provincial Tobacco Tax Revenues
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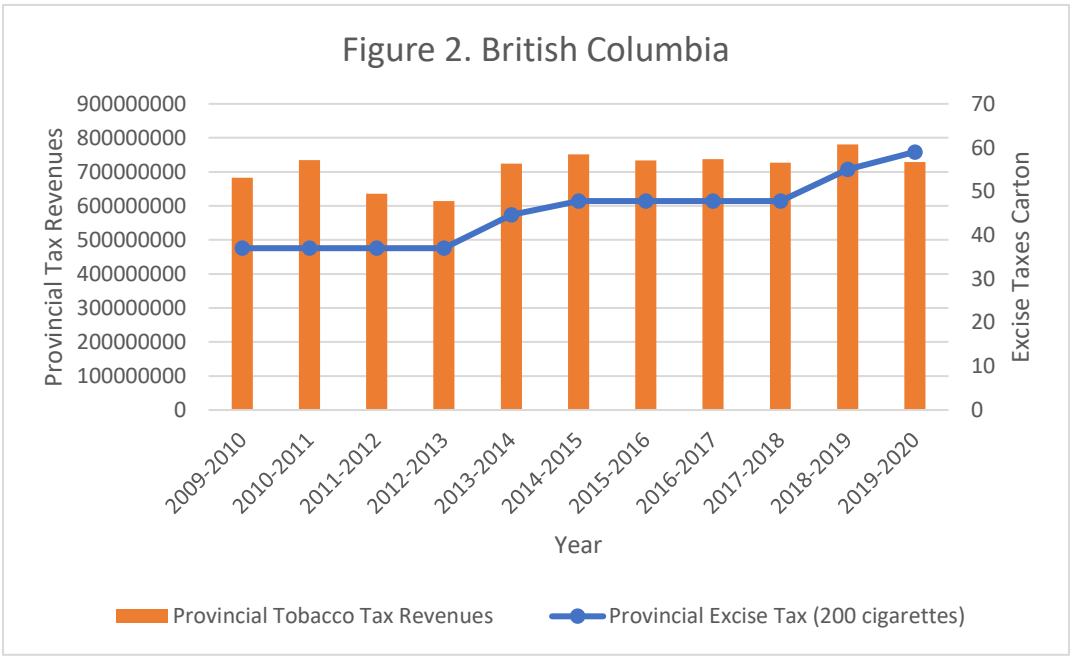
Figure 2. British Columbia
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Provincial Tax Revenues
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Excise Taxes Carton
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Provincial Excise Tax (200 cigarettes)

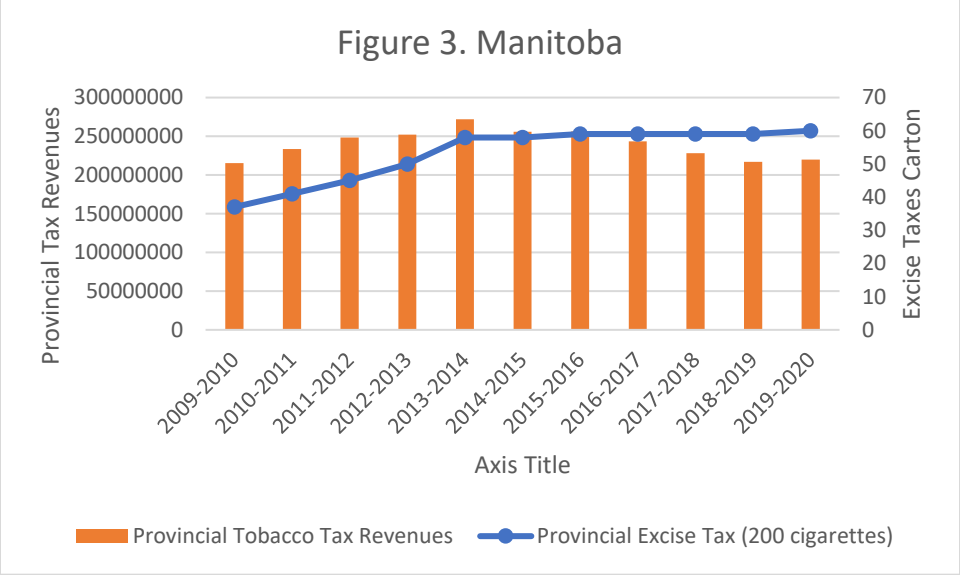
Figure 3. Manitoba
Provincial Tax Revenues
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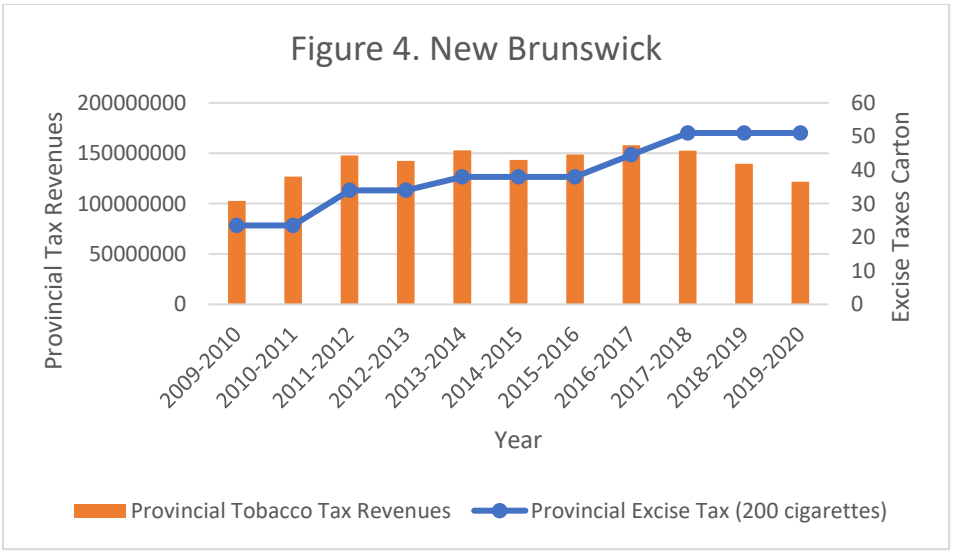
Figure 4. New Brunswick
Provincial Tax Revenues
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Provincial Excise Tax (200 cigarettes)

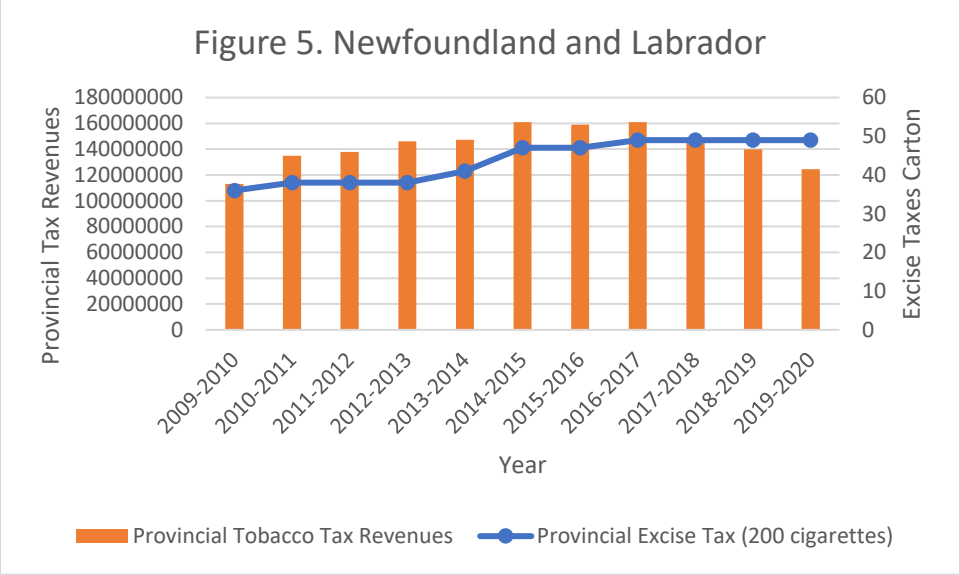
Figure 5. Newfoundland and Labrador
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Provincial Excise Tax (200 cigarettes)

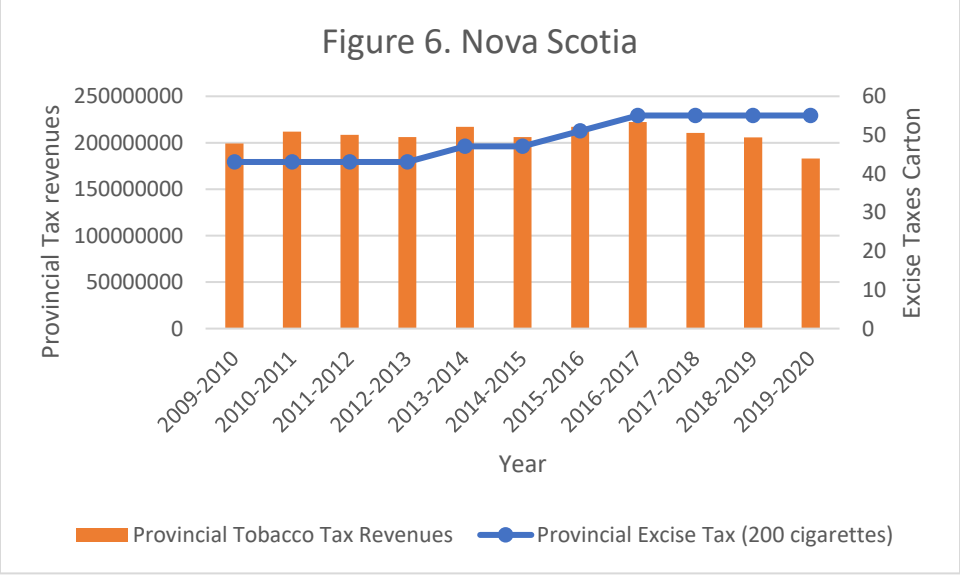
Figure 6. Nova Scotia
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Year
Provincial Tobacco Tax Revenues
Provincial Excise Tax (200 cigarettes)

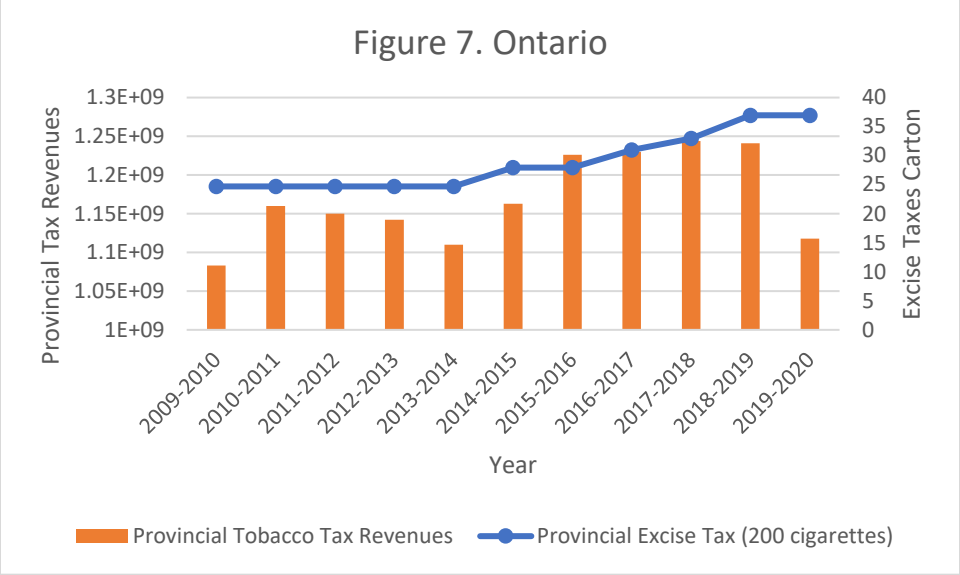
Figure 7. Ontario
Provincial Tax Revenues
1.3E+09
1.25E+09
1.2E+09
1.15E+09
1.1E+09
1.05E+09
1E+09
Excise Taxes Carton
40
35
30
25
20
15
10
5
0
2009-2010
2010-2011
2011-2012
2012-2013
2013-2014
2014-2015
2015-2016
2016-2017
2017-2018
2018-2019
2019-2020
Year
Provincial Tobacco Tax Revenues
Provincial Excise Tax (200 cigarettes)

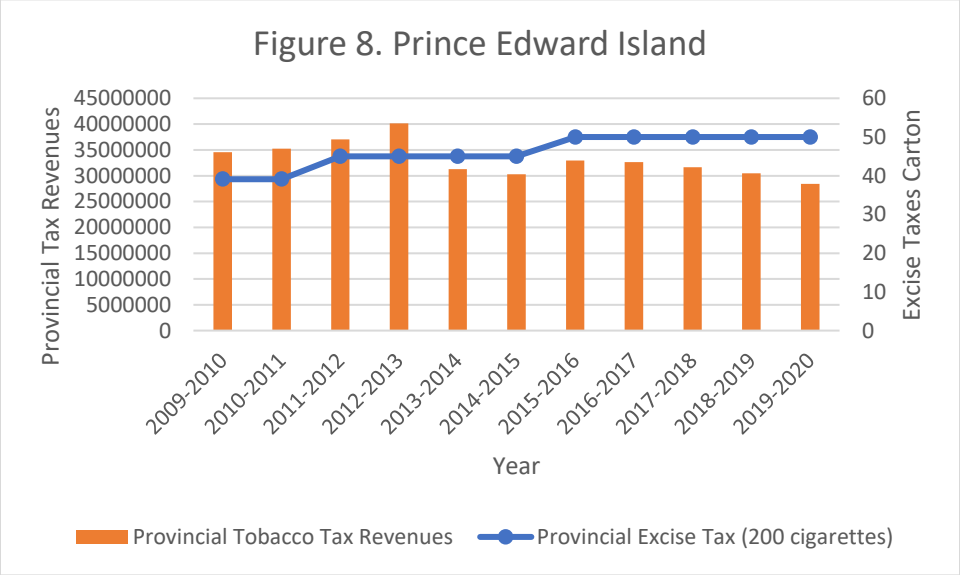
Figure 8. Prince Edward Island
Provincial Tax Revenues
45000000
40000000
35000000
30000000
25000000
20000000
15000000
10000000
5000000
0
Excise Taxes Carton
60
50
40
30
20
10
0
2009-2010
2010-2011
2011-2012
2012-2013
2013-2014
2014-2015
2015-2016
2016-2017
2017-2018
2018-2019
2019-2020
Year
Provincial Tobacco Tax Revenues
Provincial Excise Tax (200 cigarettes)

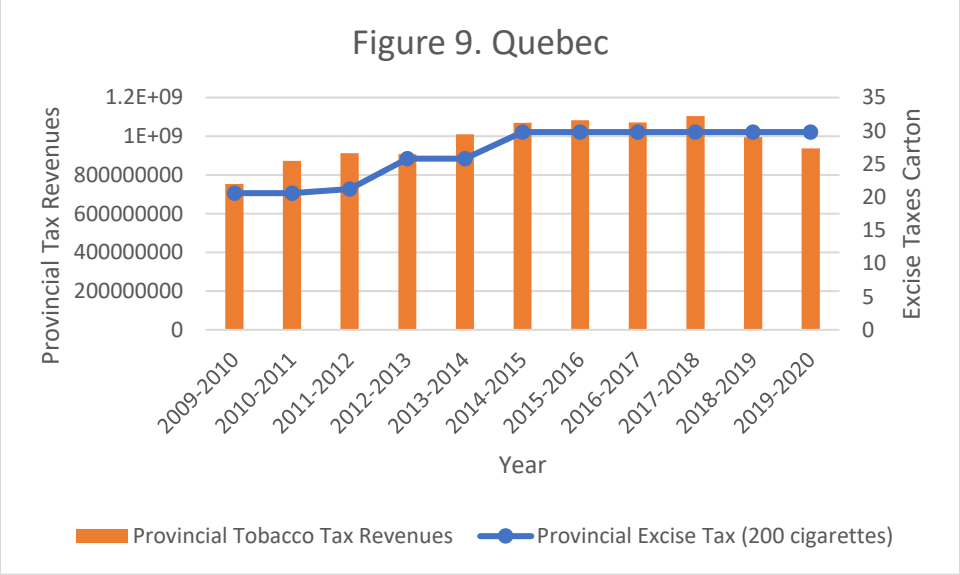
Figure 9. Quebec
1.2E+09
1E+09
800000000
600000000
400000000
200000000
0
Provincial Tax Revenues
35
30
25
20
15
10
5
0
Excise Taxes Carton
2009-2010
2010-2011
2011-2012
2012-2013
2013-2014
2014-2015
2015-2016
2016-2017
2017-2018
2018-2019
2019-2020
Year
Provincial Tobacco Tax Revenues
Provincial Excise Tax (200 cigarettes)

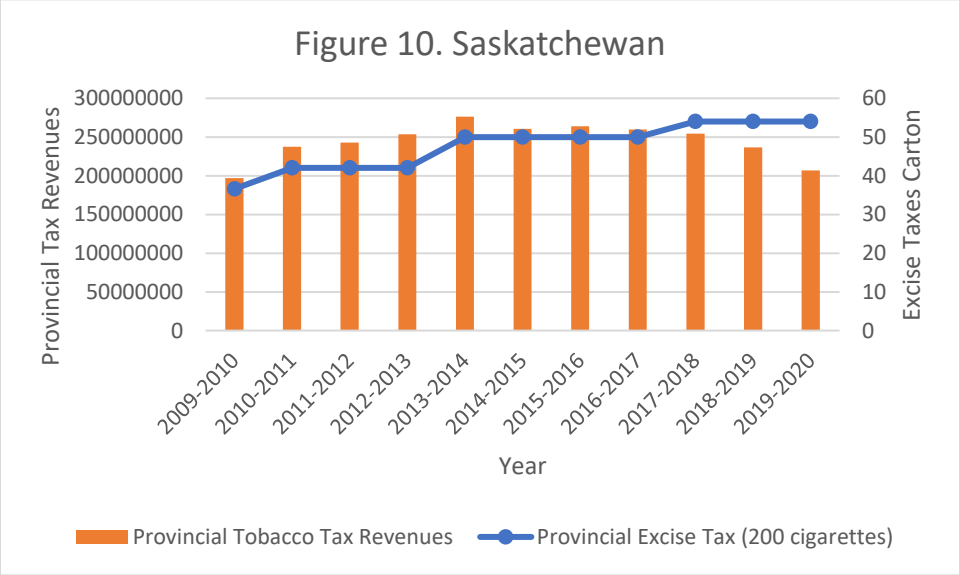
Figure 10. Saskatchewan
300000000
250000000
200000000
150000000
100000000
50000000
0
Provincial Tax Revenues
60
50
40
30
20
10
0
Excise Taxes Carton
2009-2010
2010-2011
2011-2012
2012-2013
2013-2014
2014-2015
2015-2016
2016-2017
2017-2018
2018-2019
2019-2020
Year
Provincial Tobacco Tax Revenues
Provincial Excise Tax (200 cigarettes)

On the other hand, what is important to note is the relative stability of provincial tax revenues for Quebec from 2014–2015 onwards, which is consistent with the previously discussed studies that note the success of its anti-contraband tobacco enforcement initiatives. This stability occurred despite the clear decline in legal cigarette sales in that province over the time period. In fact, available data demonstrates that legal sales have been dropping in all provinces from 2010–2013 onwards.[16]

Given evidence from previous research and the previously noted data trends that are suggestive of a relationship between higher excise taxes and reduced revenues, this study makes the following recommendations to curb the growth of underground tobacco markets.

First, federal and provincial governments should not implement further increases to tobacco taxes without considering the effects that tax increases might have in encouraging growth in the underground economy and corresponding involvement by organized crime. Keeping cigarette taxes at current levels will ensure they remain high enough to serve as a deterrent for youth smokers (Sen et al., 2010) and to also encourage smokers to attempt cessation by using vaping products.

Second, federal and provincial governments should consider implementing policy mechanisms that help coordinate tobacco taxes across jurisdictions. Such a step would help ensure a stable source of government revenues while mitigating the growth of underground alternatives.

Third, policymakers must work in collaboration and partnership with First Nations to implement tobacco taxes on reserves. First Nations have the right to sell tax-free tobacco to their residents, and the Lickers Report (2012) indicates that some Chiefs view tobacco production to be vital for their local economies and job creation. As suggested by Leuprecht (2016), a possible strategy would be to allow First Nations governments to charge lower taxes than those implemented by the province. This would still maintain a price differential relative to off-reserve cigarettes, which might benefit certain community members. Retailers would collect the tax revenue and remit it directly to local reserve governments, which could then, for example, allocate the funds to community development, infrastructure and job creation.

Fourth, governments must adopt stricter enforcement measures to curb the underground market and to especially learn from strategies employed by Quebec. Leuprecht (2016) notes the success of Project Access in Quebec, which facilitates partnerships between federal and provincial agencies. One objective of the project is to stop the flow of contraband tobacco. This initiative has been linked to significant seizures of contraband. It is also important to note that the observed decline in contraband tobacco from 2008 onward coincides with the launch of the RCMP's Contraband Tobacco Enforcement Strategy. Further, in May 2010, a Combined Forces Special Enforcement Unit–Contraband Tobacco Initiative was established to bring together federal,

[16] Please see https://www.canada.ca/en/health-canada/services/publications/healthy-living/federal-provincial-territorial-tobacco-sales-data/page-2.html#CIG_ab for further details, last accessed September 9, 2022.

provincial and municipal law-enforcement agencies to target organized crime involved in contraband tobacco smuggling in the St. Lawrence Valley region. This emphasis on an area near or in Quebec as well as the unique initiatives launched by the Quebec government are probably responsible for the significant drop in contraband tobacco estimates for that province.

Fifth, federal and provincial governments must allocate resources to accurately defining the magnitude of illegal markets. This should lead to informed and efficient policy decisions on tobacco taxation.

Finally, federal and provincial governments should invest in campaigns that raise awareness that consuming illicit tobacco is illegal and encourages the growth of organized crime involvement.

III. Vaping

The federal government has announced a new national vaping tax that came into effect on October 1, 2022. The new excise tax will be $1 for every two millilitres for vaping products for the first 10 millilitres of vaping liquid and, subsequently, $1 for every additional 10 millilitre of vaping liquid.[17] Budget 2022 also contains an example of the result of such a taxation strategy. Specifically, it uses the example of a 30-millilitre bottle of vaping liquid, which would then carry an excise duty of $7.00 due to the $5.00 tax for the first 10 millilitres and $2.00 for the remaining 20 millilitres.[18] The budget document also projects revenues of $654 million over the next five years. Further, the federal government has indicated that it would like the provinces to implement a similar corresponding tax, with proceeds to be split evenly between the federal and provincial governments.

In its initial consultation, the federal government did recognize that e-cigarettes are less hazardous to health relative to combustible cigarettes.[19] PHE has explicitly encouraged the use of vaping products as a means for smoking cessation and harm reduction. The attitude of many public health organizations/advocacy groups in Canada is quite different, with strong opposition to encouraging access to vaping products and support for high taxes on vaping products.[20] However, research by PHE indicates that e-cigarette vapour contains less than 5% of the toxins in combustible cigarette smoke.[21] Hence, while vaping products are detrimental to health as they contain nicotine (which induces dependence), they do not contain carcinogens that are created by combustion. As noted by Irvine (2022), “e-cigarettes are reduced-risk, not zero-risk, products.”[22]

[17] This discussion focuses on vaping products for tobacco alternatives and not for cannabis.
[18] See https://www.ctvnews.ca/politics/budget-includes-pocketbook-promises-on-low-alcohol-beer-vaping-and-menstrual-products-1.5852712, last accessed September 9, 2022.
[19] See https://www.budget.gc.ca/2021/report-rapport/anx6-en.html#excise-duty-on-vaping-products for further details. Last accessed September 9, 2022.
[20] See for example https://cancer.ca/en/about-us/media-releases/2022/federal-budget-2022. Irvine (2019) also has a relevant discussion (https://www.cdhowe.org/intelligence-memos/ian-irvine-%E2%80%93-vilification-vaping), last accessed September 10, 2022.
[21] See https://www.gov.uk/government/publications/vaping-in-england-evidence-update-february-2021, last accessed September 9, 2022.
[22] See https://www.cdhowe.org/intelligence-memos/ian-irvine-vaping-tax-reprise, last accessed September 9, 2022.

Therefore, while negative health outcomes from vaping are believed to be smaller in magnitude, consuming nicotine and other chemicals from vaping is also detrimental to health. Policy measures should also ensure vaping is not attractive to youth and that vaping devices or liquids are not easily accessible to them. Hence, vaping products should be taxed, but at a lower rate than cigarettes to incentivize smokers to switch to vaping.

There is preliminary evidence that the availability of vaping products has resulted in fewer cigarette purchases by Canadian smokers. Using data from a major convenience store chain, Xu et al. (2022) found that entry by JUUL, a leading e-cigarette brand, in different Canadian markets from 2017–2019 was correlated with a statistically significant reduction in cigarette sales. East et al. (2021) compared two nationally representative but methodologically different surveys fielded before and after the federal legalization of nicotine vaping products in 2018. Their results suggest a relationship between decreases in combustible cigarette smoking and apparent increases in use of vaping products. Some studies from other countries based on public health surveillance data demonstrate an association between increased vaping prevalence and decreased smoking prevalence among adults following introduction of vaping/e-cigarette products (Levy et al., 2019; Simonavicius et al., 2020), as well as an increase in successful quit attempts by smokers using such products (Zhu et al., 2017; Saffer et al., 2020).

Irvine (2020) makes the compelling point that optimal taxation of vaping products should be dependent on nicotine concentration, which would enable a cleaner benchmark against corresponding tobacco rates. As an example, Irvine took the highest permissible nicotine concentration of 20 mg/mL, which could yield the same nicotine as in a pack of cigarettes (or 4 mL of a 10 mg/mL concentration). As noted above, a recent study by PHE indicates that e-cigarette vapour contains less than 5% of the toxins in combustible cigarette smoke, which could be taken as a proxy for the health risk associated with consuming vaping products.

Irvine (2022) increased the possible risk factor to a tenth of the corresponding health risks from smoking cigarettes. Therefore, e-cigarettes would have an excise levy of one tenth the rate imposed upon combustible cigarettes. Irvine (2022) calculated the average federal and provincial tax rate for a pack of cigarettes to be roughly $9, then 2 mL of 20 mg/mL liquid would carry a levy of $0.45/mL, or $4.50/10 mL. If the nicotine concentration is lower at 10 mg/mL of e-liquid, then the combined federal and provincial tax rate would be halved at $2.25. Further, if taxes are split equally between federal and provincial governments, then we arrive roughly at the $1/2 mL federal tax rate proposed by the federal government.

While vaping taxes should be conditional on nicotine concentration, for now the federal government has decided to focus on the amount of liquid purchased. The amount of vaping liquid required by a smoker attempting to quit is conditional on many factors besides just the amount of nicotine concentration. For example, an ex-smoker might end up vaping quite a bit because of fewer restrictions on vaping activities (relative to smoking). The website canadavapes.com gives

a range of values for e-liquid use based on averages calculated from customer purchases.[23] The data suggests that 240 mL of e-liquid in the form of two 120 mL bottles might be reasonable in terms of monthly consumption for a former smoker used to smoking a pack a day. Other data from canadavapes.com and comparable websites suggests that a bottle of 120 mL may be purchased for roughly $50, so two bottles would cost approximately $100.

The new federal policy implies that 120 mL of e-liquid would be taxed $5 for the first 10 mL and $11 for the remaining 100 mL. Hence, two 120 mL bottles result in $32 of federal taxes and a total cost of $132. This is much cheaper than purchasing a legal pack of cigarettes. In Ontario, the average cost of a pack of cigarettes is $12.26, leading to a monthly (30 days) expenditure of $367.80 for a pack-a-day smoker. However, it is important to consider that a pack of contraband cigarettes can be purchased for $4.00.[24] If that is the case, monthly purchases of a pack of illegal cigarettes each day would result in roughly $120 in expenditures. The availability of contraband tobacco then helps define the maximum amount of taxes that can be imposed on vaping products if policymakers are interested in incentivizing smokers to quit. This analysis suggests that further taxes imposed by provinces may considerably reduce the incentive for smokers to consider switching to vaping products. It is also important to acknowledge that this report does not take into account the additional costs vapers face through the purchase of equipment such as starter kits and heating coils, or the fact that some smokers might need more than 240 mL of e-liquid.

In summary, it is recommended that the federal government impose no further taxes on e-liquid as long as contraband tobacco is easily accessible. If provinces impose their own excise taxes on e-liquid, they should be lower than corresponding federal excise taxes and should also not lead to significant price increases for e-liquid. Federal government projections for tax revenues from the new e-liquid tax suggest much lower revenue relative to tobacco taxes. Per the federal government's calculations, the current proposed federal tax on vaping products projects revenues of $654 million over the next five years. This is in contrast to the roughly $3 billion earned through federal taxes on tobacco in 2019–2020. Total federal and provincial tobacco tax revenues for the same year were approximately $7.5 billion. The policy direction of governments should remain on the path of minimizing taxes and tax revenues from vaping products.

Following Irvine (2019), it is also recommended that resources be invested to reduce the attractiveness of vaping to teens. As is the case in the U.K., sale of vaping products to individuals aged under 18 should be prohibited. Age checks must be enforced at points of sale, with fines imposed on retailers who sell to minors without age checks as well as on minors who purchase/possess vaping products. Further, advertising that glamorizes vaping should not be permitted, and governments might consider social media campaigns with popular influencers to highlight the dangers of nicotine consumption and addiction from vaping.

[23] See https://canadavapes.com/info/much-e-liquid-will-need.html, last accessed September 9, 2022.
[24] See https://www.thespec.com/news/hamilton-region/2022/06/01/contraband-tobacco-illegal-cigarettes.html, last accessed September 9, 2022.

Finally, while diversity in products in terms of e-liquid taste should be encouraged to enhance the attractiveness of vaping to smokers, flavours that are obviously attractive to teens — such as bubble gum or other candy-related options — should not be permitted. In a recent settlement with 33 states and Puerto Rico, JUUL Labs agreed to pay slightly less than half a billion dollars and to not employ marketing practices that might be particularly influential to teens such as using cartoons, paying social media influencers, depicting younger people using their products, advertising on billboards and public transportation or placing advertisements in any outlets unless 85% of its audience is adults.[25] The settlement also includes restrictions on where JUUL products may be placed in stores and requires age verification for all sales. These restrictive marketing and sales practices could certainly help in discouraging youth from starting to vape and could co-exist with lower product taxes to retain the harm reduction benefits for adults.

IV. Cannabis

On October 17, 2018, the *Cannabis Act* came into effect and Canada became the second country in the world to legalize the use of recreational cannabis and permit its retail sale. Initially, all the provinces and territories agreed to coordinate taxes with the federal government. The agreement was that the combined rate of all federal, provincial and territorial cannabis-specific duties and taxes on dried cannabis flower should not exceed the higher of $1 per gram or 10% of a producer's selling price.[26] In 2019, Cannabis 2.0 products were legally launched in Canada, which included alternatives to combustible products, such as cannabis-based edibles, vapes, beverages, oils and topicals. The availability of such products is obviously important from a harm reduction perspective.

Table 3 documents current federal taxes on dried/fresh cannabis as well as for Cannabis 2.0 products that are based on THC levels. These rates are available on the Canada Revenue Agency website.[27]

[25] Please see https://abcnews.go.com/Business/juul-agrees-pay-4385-million-settlement-marketing-youth/story?id=89410481 for further details, last accessed September 9, 2022.

[26] See https://www.wolterskluwer.com/en-ca/expert-insights/taxation-cannabis-canada, last accessed September 9, 2022. The revenues from excise duties on cannabis would be collected by the federal government and shared with the provinces, with 75% going to provincial and territorial governments and the remaining 25% retained by the federal government. Further, federal revenues from the excise duty were capped at $100 million per year for the 24 months following legalization, with any surplus distributed to the provinces and territories.

[27] https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/excise-duties-levies/collecting-cannabis.html.

Table 3. Cannabis Taxation Rates

Cannabis Product	Cannabis Duty		Additional Cannabis Duty (not applicable in Manitoba)	
	Flat-rate	**Ad Valorem**	**Flat-rate**	**Ad Valorem**
Dried/fresh cannabis	$0.25/g of flowering material	2.5% of the dutiable amount for the cannabis product	$0.75/g of flowering material	7.5% of the dutiable amount for the cannabis product
	$0.075/g of non-flowering material		$0.225/g of non-flowering material	
Cannabis plants and cannabis plant seeds	$0.25/plant	2.5% of the dutiable amount for the cannabis product	$0.75/plant	7.5% of the dutiable amount for the cannabis product
	$0.25/seed		$0.75/seed	
Edible cannabis, cannabis extracts and cannabis topicals	$0.0025/mg of total THC	0% of the dutiable amount for the cannabis product	$0.0075/mg of total THC	0% of the dutiable amount for the cannabis product

Table 3 confirms that the basic tax structure for dried/fresh flower has remained unchanged since 2018. While dried/fresh cannabis is not taxed based on THC levels, Cannabis 2.0 products are taxed dependent on the level of THC. In addition to the above taxes, some provinces impose a sales tax adjustment through an additional provincial ad valorem rate. Specifically, additional ad valorem tax rates in Alberta, Ontario and Saskatchewan are 16.8%, 3.9% and 6.45%, respectively. Starting February 25, 2022, Alberta Gaming, Liquor and Cannabis (AGLC) introduced a 6% markup on all wholesale purchases of cannabis by Alberta retailers. At the same time, the 2% public education fee applied to licensed producers was eliminated.

A study by Deloitte Canada (2021) points to the economic impacts of the Canadian cannabis industry since legalization. Specifically, the study found legal sales of cannabis products to be roughly $11 billion from 2018–2021, and the industry spent almost $29 billion in capital expenditures from construction activity. Further, the cannabis industry had contributed $43.6 billion to Canada's GDP, sustained 98,000 jobs and generated $15.1 billion in tax revenues. These statistics imply that legalization has been successful and resulted in considerable economic impacts for the country. However, the report ignores the considerable loss in tax revenues from a flourishing underground economy (BC Chamber of Commerce, 2022).

Evidence from survey data supports the existence of strong underground markets for cannabis products. Health Canada's 2021 Canadian Cannabis Survey asked respondents who used cannabis in the past 12 months how often they purchased any cannabis from legal/licensed sources and from illegal/unlicensed sources. While a higher percentage (43%) indicated they always obtain cannabis from a legal/licensed source in 2021 than in 2020 (37%), the implication is that there is a significant portion of the population that may access illegal sources. There was also a higher percentage of respondents (63%) who indicated that they never obtain cannabis from an illegal/unlicensed source in 2021 compared to 2020 (55%). This suggests that 37% of users have had some purchases from illegal sources, which is likely an underestimate of the actual magnitude of underground market purchases given the likelihood of respondents not providing accurate answers on illegal consumption. The existence of significant underground markets is also supported by the Ontario Cannabis Store (OCS), which estimates the illegal market share to be roughly 40%.[28]

The existence of strong underground markets should not be surprising given findings of significant price differences between legal products and illegal alternatives. The 2021 Canadian Cannabis Survey reveals significant price differentials between legal and illegal products, with the average price per unit for dried flower/leaf to be $9.78 per gram and $8.32 per serving for edibles, both unchanged from 2020. However, it is important to understand that the price for legal products reflects provincial markups and taxes. This is explored more substantially in research by EY (2022), which also yielded evidence on a significant price differential between legal and illegal alternatives. Its analysis based on flower (1 g), pre-roll (1 g), vape (750 mg) and edible (10 mg) products in Ontario suggests that government taxes and provincial markups represent 46.6% of the price of a basket of legal cannabis products. In terms of specific price differences, EY (2022) found a relatively small gap between the per gram price of legal ($6.70) and illegal flower ($6.55), but more pronounced differences for pre-roll (15%), vape (24%) and edibles (90%).

There are, of course, other important reasons behind the presence of strong illegal markets for cannabis, most of which are the legacy of specific market structures adapted by certain provinces. As documented by Sen (2018), there were considerable differences across provinces, with Quebec, New Brunswick, Nova Scotia and Prince Edward Island deciding to mimic existing liquor

[28] See https://cdn.shopify.com/s/files/1/2636/1928/files/OCS-InsightsReport_Q3-2021.pdf?v=1649948125 for further details, last accessed September 9, 2022.

distribution models by selling cannabis through government-owned retail stores. On the other hand, Alberta opted for a purely private sector retail distribution channel, while British Columbia chose a hybrid public–private system, selling cannabis through some government-owned stores, but allowing the private sector to take the lead. Again, these models are consistent with liquor control policies in these provinces.

In contrast, Manitoba, Newfoundland and Labrador, and Saskatchewan have decided to allow private retail sales with liquor control authorities responsible for regulating private stores. Sen (2018) noted several concerns with provincial governments engaged directly with selling cannabis products. In particular, Sen says:

> "Of course, there is nothing intrinsically wrong in having different retail distribution systems across provinces. It might be efficient as governments are able to tailor structures specifically to local needs. However, government distribution systems have several inherent flaws, chiefly stemming from the fact that they are a monopoly. With the absence of competitive pressures, there is no incentive to compete on prices, be efficient and, most important from the perspective of marijuana products, ensure that they are well stocked with products to accommodate a diverse array of consumer tastes. This is critical given the wide variety of edibles and cannabis-infused products, which consumers may prefer and wish to try out. If a sufficient diversity of products is not available, then consumers clearly have an incentive to go to the black market.
>
> But the private/public model is not the only critical component of whether a legal marketplace will successfully compete with the illegal one. Another legitimate concern would be whether the chosen mode of retail distribution results in an insufficient number of stores, inconveniencing consumers and consequently facilitating the existence of widespread black markets."

These concerns have turned out to be somewhat prophetic. The availability of a diverse array of products at lower prices — due in part to the absence of strong retail competition — along with the lag in rollout of Cannabis 2.0 products helped the underground market for such goods gain firm footholds. Underground alternatives also became popular due to time delays in online deliveries. However, what proved critically important in the larger provinces of Ontario and Quebec were restrictions on the number of retail outlets, which again was noted by Sen (2018). While there is a sufficient number of retail stores now, the lack of retail access post-legalization helped underground dealers build significant customer networks.

In summary, there are similarities between how vaping alternatives to tobacco and cannabis should be treated from a policy perspective. The recommendations in this report are consistent

with those put forward by EY (2022). First and foremost, there should be a reduction in federal and provincial taxes on cannabis products as well as a harmonization of tax rates across provinces. It is recommended that Alberta, Ontario and Saskatchewan either eliminate or significantly reduce their specific ad valorem sales adjustment taxes. The "higher of $1 per gram, or 10% of a producer's selling price" should be modified to the "higher of $0.75 per gram, or 7.5% of a producer's selling price" to reduce price differentials between legal and illegal alternatives to dried/fresh cannabis, which remains the majority of legal sales despite rapid increases in Cannabis 2.0 products.

Federal and provincial governments should also consider reducing taxation of Cannabis 2.0 products, which is consistent with harm reduction principles. A possible step would be to reduce the total tax rate to $0.0075/mg of total THC. This strategy would be consistent with the rather large legal–illegal price differentials for these goods that were found by EY (2022). Further, while tax reductions improve access to cannabis products for adults, it is paramount that youth do not have easy access to cannabis. This is of course compromised by the existence of illegal alternatives. Significant resources should be spent on social media public awareness campaigns (especially those targeting youth) about the health risks and danger of purchasing contraband cannabis products. Similarly, there should be social media campaigns to educate users on the harm reduction benefits of non-combustible cannabis products/cannabis. There should be specific budgeting that provides resources to enforcement agencies to combat the spread of illicit cannabis, in tandem with measures allocated to eradicate underground markets for tobacco and vaping products.

V. Online Gaming

On April 4, 2022, Ontario took the bold move of legalizing online gaming and establishing Canada's first competitive regulated market for online gaming and sports betting. There are projections from industry analysts that in a few years, Ontario could be the third largest regulated online market in North America, behind the comparatively mature U.S. markets of New Jersey and Pennsylvania.[29]

Moving toward regulated markets is a significant departure from the existence of a government-owned monopoly on online gaming. Firms wishing to participate in the Ontario market must register with the Alcohol and Gaming Commission of Ontario (AGCO), agree to comply with AGCO standards and sign a commercial contract with AGCO's iGaming Ontario (iGO) subsidiary. Ontario must also ensure that the market is consistent with relevant provisions of Canada's federal Criminal Code that require provincial government agencies to "conduct and manage" any

[29] Please see https://g-mnews.com/en/canada-gross-gaming-revenue-for-ontario-could-reach-usd-2-54-billion-by-2026 for further details, last accessed September 9, 2022. The article also notes differences in how provinces offer online gaming and sports betting to the public. Such online activities are available in British Columbia, Alberta, Manitoba, Quebec and New Brunswick through province-owned lottery corporations. The Atlantic Lottery Corporation offers limited online sports betting, bingo and lottery games but not online casinos in the provinces of Newfoundland and Labrador, Nova Scotia and Prince Edward Island. Internet gaming in Saskatchewan falls under the jurisdiction of the Saskatchewan Indian Gaming Authority.

form of commercial gaming permitted in their jurisdictions. In other words, Ontario has the responsibility to ensure that legalized commercial gaming does not become associated with criminal activities.

There are expectations that Ontario's experiment with a regulated market should be successful, with a diversity of established firms that have either entered or could enter the market, especially those that have been considered "grey market" players. In this respect, the initial evidence has been encouraging, with well-known offshore Canadian private operators such as bet365, Entain, Pinnacle and PokerStars obtaining registrations with the AGCO.[30] Established U.S. firms such as BetMGM, PointsBet and World Series of Poker have received ACGO registrations as well. There are also Canadian brands such as theScore Bet and NorthStar Gaming that have entered the Ontario market. Finally, there are casinos that also have the potential to be strong market players, as does the government-owned Ontario Lottery and Gaming Corporation (OLG), which offers many different online options. A key reason behind expectations on strong market growth is the fact that, unlike most U.S. states, Ontario sportsbooks are not confined to specific approved wagering events and can therefore offer betting on almost any sport or novelty event, as in the United Kingdom and many European countries (except France, Portugal and Germany), which should be attractive to players. As of September 1, 2022, iGO reported 40 regulated online sports betting, iGaming and poker sites live in the province. Further, U.S. markets mostly focus on sports betting, while the Ontario market also offers peer-to-peer poker and online casino games.

While not eliminating underground markets, the availability of multiple regulated options should reduce the attractiveness of illegal options for players. Regulated markets imply the existence of government agencies that can monitor products offered by private operators and ensure they are fair, with reasonable opportunities for winnings; have clear communications to players to facilitate informed choices; and have truthful advertising, with no advertising targeting minors. A complete list of the AGCO's requirements for private operators with respect to standards for internet gaming is available on its website.[31]

Further, regulated markets enable the monitoring of problem behaviour and delivery of messages that point out the dangers of problem gaming and indicate the availability of relevant government resources, which is important from a harm-reduction perspective. The AGCO has clear requirements for mechanisms that can monitor player risk profiles and behaviours for the purpose of detecting signs of potential gambling-related harm among players and of being able to help with available resources upon request from players or other affected parties. Finally, the availability of legalized online gaming is extremely important given the findings of the Cullen Commission Report (2022), which links money laundering to gambling.

[30] Please refer to https://www.newswire.ca/news-releases/pokerstars-officially-launches-in-hometown-ontario-826633815.html, https://www.casino.org/news/pinnacle-latest-sportsbook-to-join-ontarios-regulated-online-market and https://www.legalsportsreport.com/66443/bet365-making-switch-ontario-sports-betting-gray-market. These sites were last accessed September 9, 2022.

[31] Please see https://www.agco.ca/ensuring-game-integrity-and-player-awareness, last accessed September 9, 2022.

The initial reports on gaming revenue indicate that the Ontario market has begun well. According to IGO's first quarter market report for April–June 2022, approximately $4 billion was wagered, earning companies $162 million in gross gaming revenues.[32] The IGO receives 20% of such revenues, which goes to the province.[33] Further, there were 492,000 player accounts with an average monthly spend of $113.

To maintain this growth, the federal and provincial governments must ensure certain tax policy measures. First, unlike in the United States, winnings from horse racing, sports betting, lotteries, online casinos and any other games of chance are not taxed in Canada as they are considered windfall gains.[34] This strategy must be maintained to reduce the attractiveness of gaming activities in underground markets. Second, there should be no further specific corporation taxes imposed on Canadian firms, which would reduce the incentive of private operators to participate in the Ontario market. As discussed above, having fewer private operators results in less choice for gamers, and therefore greater opportunities for underground markets. Third, the 20% fee paid by licensed companies should not be increased by the province, as it is competitive with corresponding fees paid in U.S. jurisdictions.

[32] See https://igamingontario.ca/en/news/igaming-ontarios-first-report-market-performance-q1, last accessed September 9, 2022. Revenues are calculated as the sum of total cash wagers, including rake fees, tournament fees and other fees, across all live Operators from April 4 to June 30, 2022, minus player winnings and does not consider operating costs or other liabilities.
[33] The ICO uses these revenues to also pay HST on behalf of a licensed company.
[34] Please see https://www.rktaxlaw.com/are-gambling-winnings-taxable-in-canada. For the United States, see https://www.irs.gov/taxtopics/tc419. These sites were last accessed September 9, 2022.

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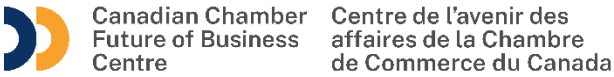
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