



## **Budget 2023 Submission**

### **Introduction**

The Cannabis Council of Canada (C3) is the national and international representative of Health Canada licensed producers and processors of cannabis. C3's mission is to promote industry standards, support the development, growth, and integrity of the regulated cannabis industry, and serve as an important resource on issues related to responsible use of cannabis for medical and non-medical purposes. Cannabis supply chain participants (retailers, advisors, suppliers, etc.) play an active role in supporting C3's efforts to contribute to the public policy objectives of legalization and the commercial success of the legal cannabis industry. Note to readers: C3 has included an "Appendix" to this submission which provides the evidence in support of the positions advanced herein.

### **The Unintended Consequences of Canada's Cannabis Policy Framework**

Canada is a world leader in responsible drug policy. Canada has pioneered harm reduction in response to the opioid health crisis. Canada's legalization of cannabis is a model to governments all over the world seeking to protect the health of its citizens and keep the proceeds of cannabis out of the pockets of criminals.

Canada's experience with four years of adult-use cannabis has been a success for governments and for Canadians but has been a significant challenge for the legal cannabis industry. The tax and regulatory architecture of cannabis is based on a set of assumptions about the economic sustainability, diversity, and future of the adult-use cannabis industry. Made by governments prior to the legalization of adult-use cannabis, these assumptions have resulted in:

- The setting of the excise tax rate at "the greater of \$1/gram or 10% of the sale price of the product."
- The creation of a Health Canada Annual regulatory fee at a rate of 2.3% of revenues.
- An Excise Tax Framework that holds licensed processors responsible for the collection and payment of excise duties.
- The setting of excessive provincial cannabis distributor mark-up rates. The Ontario Cannabis Store's rate of 20-30% of the final sale price of cannabis products, depending on the product category.
- A regulatory regime that impedes the success of the public health and safety objectives of legalization.



The consequences of the current taxation and regulatory architecture governing legal cannabis have produced a situation where:

- Few, if any, Cannabis producers and processors are able to earn a profit (see. EY's report "An Economic Analysis of Cannabis Excise Duties, Mark-Ups and Fees, May 2022.)
- Governments are experiencing a 225% increase in defaults and arrears of cannabis excise duty payments with approximately 70% of remitters in default
- In 2022, half of all companies granted protection under the *Companies' Creditors Arrangement Act* (CCAA) are Health Canada Licence Holders.
- An estimated 3,000,000 individual Canadians who invested in cannabis companies have lost more than \$131 billion.

The Cannabis Council of Canada is calling on the Government of Canada for urgent reform of the taxation and regulation of legal cannabis in budget 2023. Failure to reform these will:

- Undermine the public health and safety successes of legalization and the ability of legal cannabis companies to support these.
- Result in the closure of legal cannabis facilities and the loss of thousands of well-paying cannabis jobs, primarily in small and rural communities across Canada.
- Result in the loss of government tax revenues due to the proliferation of the illicit industry, defaults on excise duty payments, and lost income taxes.

### **Urgent Need for Reform of the Taxation and Regulation of Legal Cannabis**

On the government front, Deloitte Canada's "An Industry Makes its Mark: The economic and social impact of Canada's Cannabis Sector" (published in 2021), noted that the first three years of legalization have produced:

- \$13 billion in tax revenues, of which \$1.3 billion have come from the excise tax.
- Over 43,000 direct and another 180,000+ indirect jobs.
- \$45.5 billion to Canada's GDP.

Today, the most profitable, if not the only, cannabis businesses earning a profit are provincial cannabis distributors and retailers. For the financial year ended March 31, 2022, the Ontario Cannabis Store (OCS) announced that its profit more than doubled year-over-year to \$ 184.4 million Canadian dollars (\$133 million). In its 2020-2021 fiscal year, the Société québécoise du cannabis (SQDC) generated a profit of \$66.5 million, again nearly double the figure for the preceding fiscal year.

On the public health and safety fronts, none of the fearmongering which preceded legalization has come to fruition. There's been no increase in youth consumption of cannabis and a slight



increase in young persons’ consumption. Our workplaces, roads and communities are not plagued with problems due to cannabis consumption. Most Canadians have access to legal cannabis products.

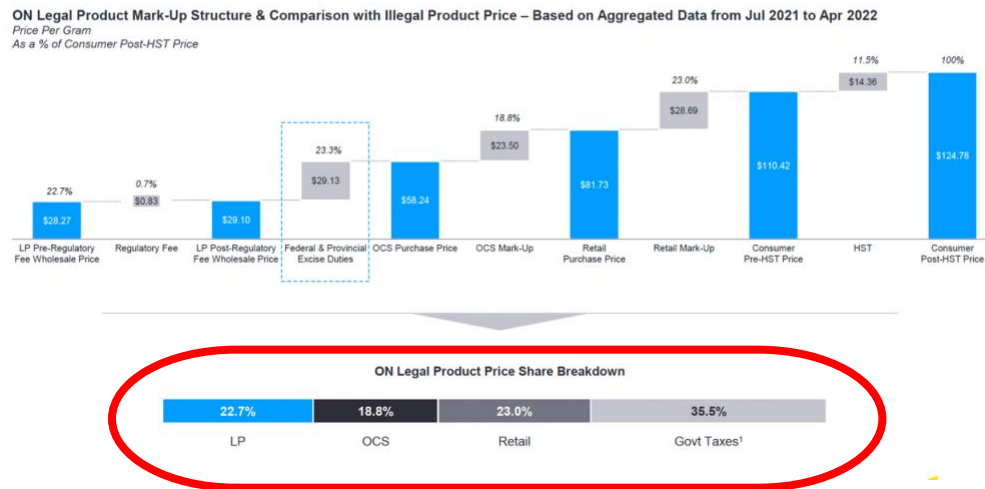
Unfortunately satisfying conclusions cannot be drawn for Health Canada licensed producers and processors who are in a full - fledged financial sustainability crisis. The licensed producer crisis threatens the social and economic benefits of legalization and the jobs of the tens of thousands of Canadians employed as a result of the legalization of adult-use cannabis. While some of the legal cannabis businesses challenges can be explained away by poor business decisions, the extent of the crisis and the viability of the industry itself speaks to governments’ responsibility and the urgent need to reform the tax and regulatory governance of legal cannabis.

The structural issues which require urgent fixing are:

A. The Excise Tax Rate

Excessive government taxes, mark-ups, and fees, leave many licensed producers with less than 25% of the final sale price paid by consumers, while government combined to absorb up to 60 % of the price of some legal products. EY’s “Economic Analysis of Cannabis Excise Duties, Mark-ups and Regulatory Fees” which analyzed the price components of the one ounce cannabis flower product found that licensed producers earned 22.7% of final sale price, but that government taxes made up 35.5 % of the price, while provincial distributor markups and retailers margins were left to split the remaining 40 % of the pie.

Excise Duties, Mark-Ups and Regulatory Fees for 28g Flower Package in Ontario  
**28g Flower Package Price Mark-Up Structure in Ontario**





The taxation of medical cannabis runs counter to the constitutional protections the Supreme Court offered related to access to cannabis medicine. The viewpoint that says only a DIN # (drug identification number) defines a medicine has produced an approach to health and harm reduction that prioritizes opioids as prescribed options, frequently leading to addiction and death.

The evidence demonstrates that legal cannabis companies are financially unsustainable at this level of taxation.

#### B. The Health Canada Annual Regulatory Fee

All licensed producers pay an annual regulatory fee to Health Canada of 2.3% of revenues or \$25,000 per year, whichever is greater. This fee is in addition to fees for regulatory services such as licenses, permits and security clearances, earning millions more for the Government of Canada. The Annual Regulatory Fee was set in 2018 prior to the legalization of adult-use cannabis. A choice was made to set the fee at the highest level presuming an immediately profitable sector. C3 has strongly opposed the approach to regulatory fees as unreasonable and inequitable, arguing that it was impossible for the nascent cannabis industry to bear the entire responsibility for funding Canada's regulatory oversight of cannabis.

In the lead up to legalization, the government developed an expansive list of planned expenditures and related them to cannabis legalization even though many of those expenditures were ongoing to support things like treaty obligations or in support of constitutionally protected medicinal cannabis programs, or in the fulfillment of public health initiatives. In particular significant resources were poured into readying police services for the social decline and vehicular operation scenarios that were widely predicted. There has never been an accounting or an offset due from the savings related to ending criminal possession prosecutions that were still occurring at a rate of 100 per 100,000 adult population in the year before legalization (estimated 25,000 cases). The mantra of increased costs was everywhere but it seems nobody thought to capture the credit for the tens of millions in annual savings to the federal and provincial justice, police, court, and jail systems for not pursuing those cases.

The industry was told only the needed amount would be collected and we would be at the table with Health Canada every step of the way. There was supposed to be a connection to service standards. Yet, there are only service standards that Health Canada has set for themselves. They are non-binding where they exist at all. Nor are there any consequences for failure to meet the standard. For example, the medical cannabis export permit service standard of 30 days isn't economically competitive, and is not in reality 30 days, as it only commences after receipt of payment which is a process that can take up to 10 days or more. Health Canada has never been open to frequent requests to set a world leading or even competitive



standard, despite the fact licence holders pay a fee for this service in addition to regulatory fees.

Health Canada’s regulatory fee presumed a very financially profitable sector. Since Fall 2020, C3 has been calling on Health Canada to revisit the fees as part of the case about the poor economic conditions for the legal cannabis sector. Health Canada engaged a consultant to consult licence holders on the regulatory fee regime, asked C3 for help getting license holders to respond, and yet they have never shared anything with C3 on this matter.

At C3’s bilateral meeting with Health Canada (November 25 2022), C3 was informed that the department had renewed the regulatory fee program on exactly the same basis for three further years. This was done with no word, no consultation, and perhaps no honest representation of how the sector is actually reeling under the combined burden of regulatory fees and taxation.

Canada’s unequal treatment of Excise and HST products:

<b>Product</b>	<b>Excise Tax</b>	<b>HST</b>	<b>Regulatory Fee</b>	<b>Public Costs</b>
Cannabis	Yes	Yes	Yes	Healthcare/Policing/ Research
Tobacco	Yes	Yes	None	Healthcare /Policing/ Research/Preventable Death
Spirits	Yes	Yes	None	Healthcare/ Policing/ Research/ Preventable Death
Beer	Yes	Yes	None	Healthcare/ Policing/Research/ Preventable Death

In the period since the legalization of adult use cannabis, October 18, 2018 to March 31, 2022, Health Canada had received more than \$ 150 Million dollars from licensed producers and processors in cannabis regulatory fees. This amount is in addition to fees applied for one - off licensing, permitting and security clearances that generated millions more.

### C. The operation of the cannabis Excise Tax Framework

The complexity of the Excise Tax Framework is a barrier to the development of an efficient cannabis supply chain, a significant operational and administrative burden on cannabis licence holders, and a restraint on licence holders’ ability to support the policy objectives of legalization.

The rapidly escalating defaults of excise duty payments by cannabis cultivators and processors can best be addressed by revising the entire Excise Tax Framework governing cannabis. Had



governments made provincial distributors liable for payment and recovery of the cannabis excise duty, like they do for wine, spirits and beer, they would not have an issue with excise tax payment defaults.

Canada's cannabis distribution system is modelled on that of alcohol, where excise taxes for beer wine and spirits are collected and remitted by provincial distributors. Cannabis excise tax system is modelled on that of tobacco, where there a handful of producers who are responsible for distribution of their products. Canada applied the tobacco excise model to cannabis, whereas it should have applied the alcohol excise model. Tax policy requires that taxes be levied as close to the consumer as possible. In the case of cannabis, this should have been at the provincial cannabis distributor level. Decisions about the operation of the excise tax were made by the federal and provincial governments, without any understanding of the implications for licence holders and their ability to support the public policy objectives of legalization. Shifting the liability of cannabis excise taxes to provincial distributors would also resolve the injustice of the excise taxation of medical cannabis.

## **Budget 2023 Recommendations**

The structural challenges threatening the financial sustainability of cannabis legalization are the product of decisions made by the Government of Canada when there was a lack practical experience with the federal legalization of cannabis. Four years later this is not the case. With data in hand demonstrating widespread economic volatility, the legal cannabis industry finds itself in search of government "partners" that are willing to make the changes needed to protect public health and safety of Canadians, the tens of thousands legal jobs created by the legal industry and to preserve the substantial tax revenues flowing from these jobs.

Regrettably, without these structural challenges the industry will lack the resources required to invest in new product formats, compete with the illicit market and launch initiatives in support of a harm reduction approach to cannabis consumption.

### **1. Immediate Relief: Annual Regulatory Fee**

Licensed producers pay a 2.3% of topline revenues Annual Regulatory Fee to Health Canada, in addition to a fee for individual regulatory services. The Cannabis Council of Canada has consistently maintained that these fees are not appropriate and do not align with the objective of eliminating the illicit market through competition from licensed producers and processors.

#### **Recommendation:**

- Eliminate the Health Canada Annual Regulatory Fee.
- Credit the CRA accounts of license holders with all regulatory fees collected since inception.



## **2. Reforming the excise tax on legal cannabis**

The Canada Cannabis Taxation Agreements (CCTA) signed by the Government of Canada and the provinces commit to the establishment of a “*Cannabis Taxation Policy Committee ....tasked with regularly monitoring the cannabis market to ensure that tax rates, mark-ups and margins are in keeping with the principles of this Agreement.*”

According to the Government of Canada “*Backgrounder: Federal-Provincial-Territorial Agreement on Cannabis Taxation*”:

*The Government of Canada is committed to legalizing, regulating, and restricting access to cannabis to keep it out of the hands of youth, and profits out of the hands of criminals. In support of these twin goals the federal government is working collaboratively with provinces and territories to ensure a coordinated and stable approach to cannabis taxation. Furthermore, Finance Ministers recognize that meeting the objectives of the legalization of cannabis will entail sustained cooperation between both orders of government and municipalities.*

According to the Department of Finance:

*“To keep cannabis out of the hands of youth and profits out of the hands of criminals, the Government is proposing an excise duty framework for cannabis products.”*

*The Ministers agree in principle on the following regarding cannabis taxation:*

### **General Principles**

- *Taxes on cannabis will be kept low to support the objectives of its legalization: keeping it out of the hands of youth, and profits out of the hands of criminals.*

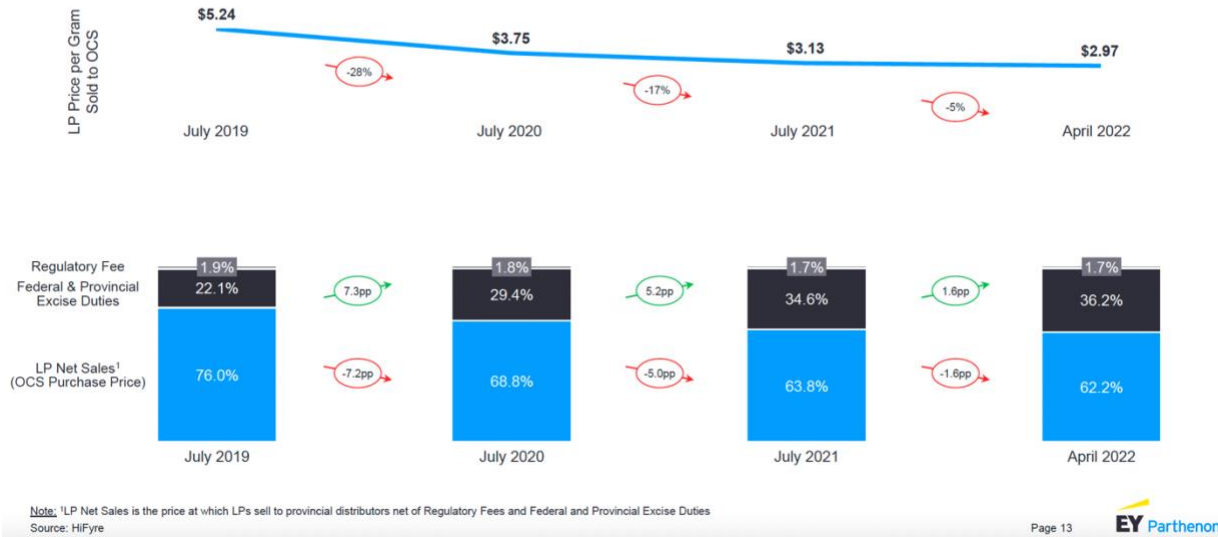
The Cannabis Council of Canada respectfully submits that the Cannabis Excise Tax Framework is a significant barrier to the ability of legal cannabis companies to support the public policy objectives of legalization, namely competition with the illicit market. To the extent that there has been success in bringing over clients from the legacy markets it must be noted that has been achieved largely on the backs of investors and small businesspeople who have been subsidizing the commoditization of cannabis flower.



Ontario Cannabis Price Analysis by Category

Flower Price Compression and Share Breakdown in Ontario

ON LP Price Trend and Share Breakdown – Jul 2019, Jul 2020, Jul 2021, Apr 2022



Source: Economic Analysis of Cannabis Excise Duties, Mark-ups and Fees, EY Parthenon, May 2022.

The financial crisis facing the cannabis industry demands an immediate effort from all levels of government on changes to the cannabis excise duty. Doing so would allow all partners to successfully capture more of the cannabis activity effectively achieving a bigger share of the public health objectives of cannabis legalization.

Recommendations:

- Eliminate the flat rate excise duty of \$1/per gram on legal cannabis and retain the 10% ad valorem rate.
- Create a Cannabis Industry SME Support Fund from all Excise duties collected and retained by Canada above and beyond \$100 million per year. (\$68 Million to March 31, 2022) to recognize and encourage small producers and future diverse market participants.
- Eliminate the tax on cannabis medicine and acknowledge that the Supreme Court of Canada never said medicine is defined by a DIN #.



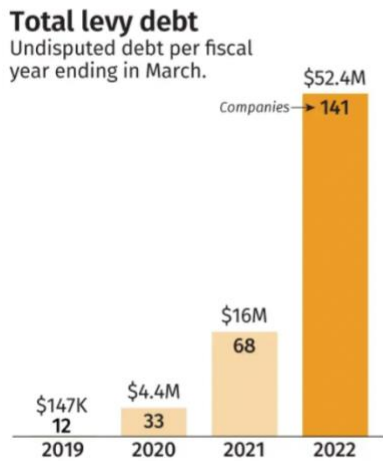


Appendix: Evidentiary Supports

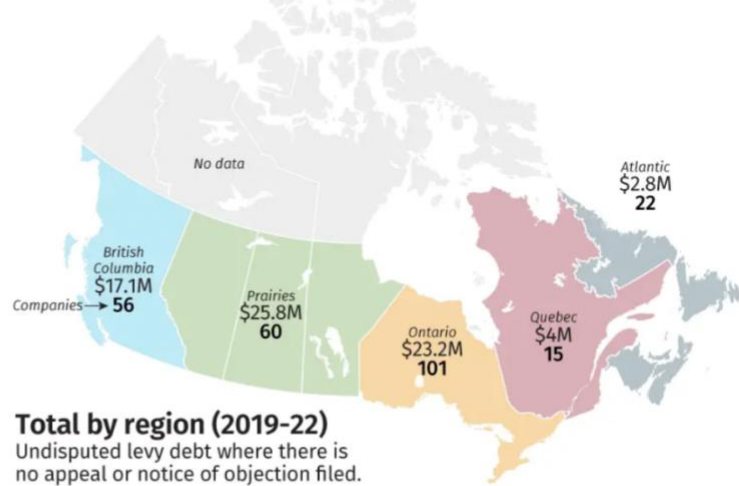
1. The default and arrears of Cannabis Excise Duty payments to the Government of Canada

### Canadian Cannabis Excise Debt Soars

The number of businesses in Canada with unpaid cannabis duties has skyrocketed since 2019. A breakdown by year and region:



Source: Canada Revenue Agency



**Total by region (2019-22)**  
Undisputed levy debt where there is no appeal or notice of objection filed.

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Source: [Canadian cannabis producers' overdue excise taxes more than triple to CA\\$52M](#), Matt Lamers, MJBiz Daily May 25, 2022

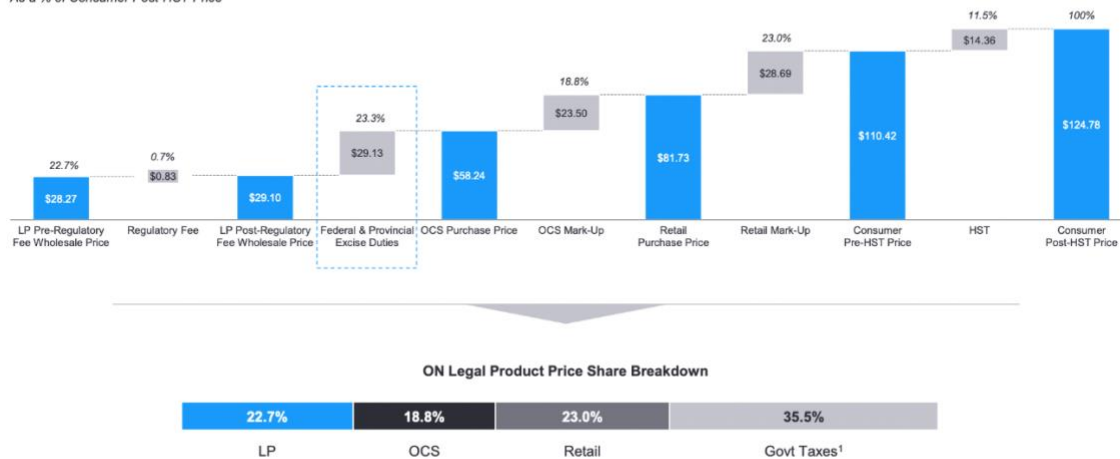


## 2. Excessive government taxes, mark-ups, and fees, which leave licensed producers with 20% to 30% of the price of legal products

Excise Duties, Mark-Ups and Regulatory Fees for 28g Flower Package in Ontario

### 28g Flower Package Price Mark-Up Structure in Ontario

**ON Legal Product Mark-Up Structure & Comparison with Illegal Product Price – Based on Aggregated Data from Jul 2021 to Apr 2022**  
Price Per Gram  
As a % of Consumer Post-HST Price



Note: <sup>1</sup>Includes Regulatory Fee, Federal and Provincial Excise Duties and HST

Source: Hifyre; mailorder-marijuana.com; buymyweedonline.net; herbapproach.org; cheapweed.io; wccannabis.co; budlyft.com

Page 21

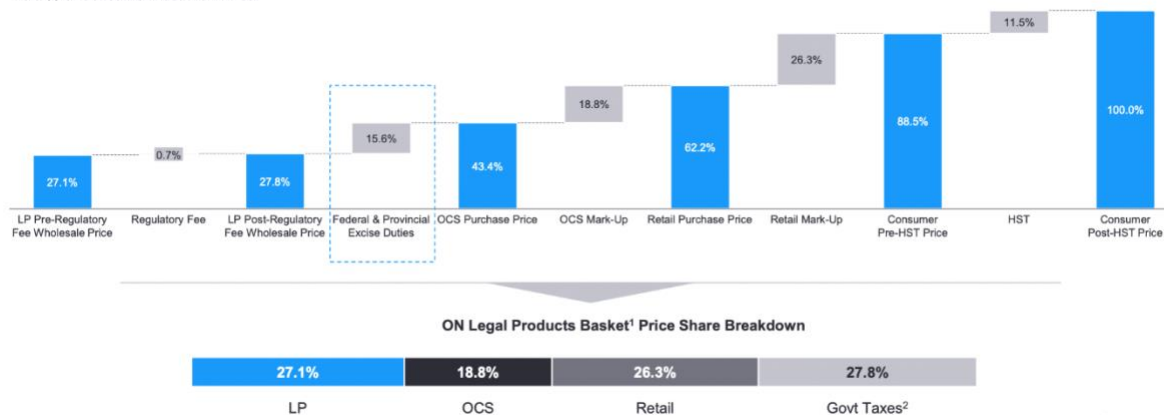


Ontario Cannabis Price Analysis and Trends

### Cannabis Price Mark-Up Structure in Ontario

Government taxes represent 27.8% of the price of a basket of legal cannabis products including flower (1g), pre-roll (1g), vape (750mg) and edible (10mg); Licensed Producers only capture 27.1% of the selling price in the value chain while the illegal market would capture the full selling price

**ON Legal Products Basket<sup>1</sup> Mark-Up Structure – Based on Aggregated Data from Jul 2021 to Apr 2022**  
As a % of Consumer Post-HST Price



**Source:** Economic Analysis of Cannabis Excise Duties, Mark-ups and Fees, EY Parthenon, May 2022.



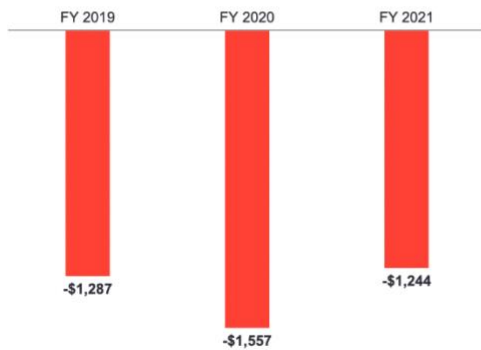
### 3. Financial Situation of Cannabis Producers and Processors

Cannabis Industry Financial Health

#### Cannabis Companies Operating Cash Flows and Market Capitalization

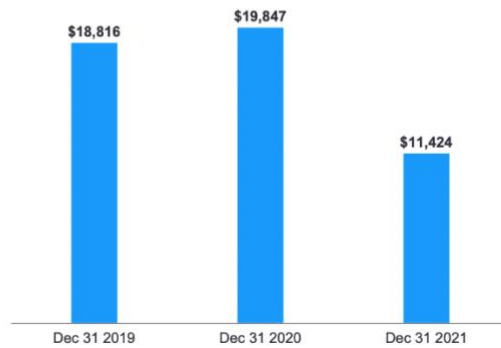
The sustainability of legal cannabis industry is at substantial risk; Licensed Producers remain unprofitable and on the verge of bankruptcy. Investors continue to exit the Canadian market

Top 10 Canadian Cannabis Companies Operating Cash Flows  
In Millions



Source: S&P Capital IQ

Top 10 Canadian Cannabis Companies Market Capitalization  
In Millions



Page 7



**Source:** Economic Analysis of Cannabis Excise Duties, Mark-ups and Fees, EY Parthenon, May 2022.



**4. 3,000,000 Canadians have lost over \$131 billion dollars as a result of investments in the legal cannabis industry**

**Canadians have lost more than \$131 billion investing in cannabis companies: firm**



Adrian Ghobrial  
CTV National News

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Share



Canadians who invested in cannabis companies have lost more than \$131 billion, according to data collected by law firm Miller Thomson, which calculated the total losses of 183 publicly traded and licenced cannabis producers.

It's a staggering number that if divided equally between an estimated three million active investors would equate to each losing about \$43,000.

Source: [Canadians have lost \\$131 billion investing in cannabis](#), CTV News, November 17, 2022.



## **5. Group 1 Carcinogen – International Agency for Research on Cancer**

Alcohol, tobacco and asbestos

### **Preventable Cancer**

Smoking      48,000 Canadians die each year from tobacco use

Alcohol      Alcohol linked to 7,000 new cancer cases in 2020.  
Every day around 8 Canadians die in hospital from conditions entirely caused by  
alcohol (source CIHI 2019)