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February 25, 2022

Re: Budget 2022 Consultation

The first few years of cannabis legalization have been fraught with challenges for producers who have been licensed under the Cannabis Regulations. The most severely impacted have been small-scale private Canadian businesses, who due to regulatory requirements are often forced to sell their products to their larger competitors. However, today, our focus is on a budgetary issue that affects **every** single licensed producer, big and small, though it is an existential issue for small and medium enterprises (SMEs) that has already forced several popular brands to go out of business (such as [Shelter Market](#) and [CannMart](#)).

The current excise duty regime for cannabis in Canada is incredibly problematic. In a nutshell, the excise duty owed on cannabis flower is currently set at \$1/g or 10%, **whichever is higher**. There has been a significant price compression since the outset of legalization. Since the licence holder is obligated to pay the higher amount, at \$1 per gram, the excise duty is often 30-130%. This is not a typo. Outdoor cannabis flower often sells for under \$1/g (and can be lower than 50 cents). For many producers in Canada, the government makes more money than the actual farmer, and this does not include sales tax, provincial markups, and the various other unavoidable costs of doing business.

This elevated excise duty regime has no parallel in any other regulated industry in Canada. Some companies are paying 30% of their top-line revenue in excise duty, and some (such as [Tantalus Labs](#)) say they pay about 3 times as much in excise duty every month as they do in payroll. The current excise regime makes it so that companies cannot be profitable. The profit that they would have made (due to sound business decisions) all goes to the government. This is unsustainable, and will result in a market where solely the largest public companies remain, due to both economies of scale and their ability to absorb these costs with the millions of dollars they received for their shares. The effects of this have already begun, with a handful of beloved and incredibly popular craft cannabis brands shutting down their operations due to an inability to be profitable, largely due to the excise duty regime.

Additionally, this excise duty regime does not differentiate between medical and recreational cannabis. Charging this much duty on medicine is completely unacceptable. [Prescription medicines are generally "zero-rated"](#), exempt from both excise duty and sales tax to keep the costs of medicine as accessible as possible. Medical cannabis is the exception to this rule, with patients required to pay both excise and sales taxes due to a technicality: cannabis prescriptions are officially "medical documents," and therefore not "prescriptions". Canada is *the only* North American jurisdiction that [taxes medical cannabis identically to recreational cannabis](#), and over 27,000 Canadians have asked for this taxation to end for medical patients.

In Canada, there are tens of thousands of small scale cannabis producers working in either unlicensed or medical markets. The vast majority of these producers are heavily involved in their communities, and a Department of Justice Canada report showed that 95% of illicit growers do not have any connection to organized crime. These producers fought for decades to legalize the medicine that they are passionate about, and most of them today are choosing not to transition to the licensed world because it doesn't make any financial sense for them to do so. If

they get a license (which will cost them hundreds of thousands of dollars), they will go out of business because it is near impossible today to turn a profit.

The cannabis sector, particularly the small and medium scale producers, suffer from assumptions that cannabis is a highly profitable enterprise, which results in a cumulative and unbearable load of fees, taxes, and other costs. For example, credit unions are among the few banks that are willing and able to open bank accounts for licensed cannabis businesses: as a result, cannabis businesses have no other choice but to pay \$250 / month in banking fees, even when there is no activity on the account. Business licenses provided by local government can be as much as ten times a regular business license. In our region, many of our long-licensed operators are still waiting to make any profit, based on the limited pathways to market, extremely high overhead, and payment schedules for the goods that they produce that do not recognize nor accommodate the precarious nature of their financing and cash flow.

If the Canadian government were to change the excise duty regime to be comparable to other regulated industries, and to reduce the excise duty on medical cannabis to be in line with other prescription medicine, a few things would happen:

1. Initially, the tax revenue for the government would decrease slightly. Using data from Bloomberg and from the [Deloitte economic impact report](#), of the taxes collected in the first three years of legalization, *only* \$1 billion of cannabis tax revenue came from the excise taxes. The remaining \$14.9 billion came from other tax sources (e.g. sales tax, corporate tax, personal income tax, property tax, etc.).
2. Licensed small-to-medium cannabis producers would stop shutting down their operations, since for the first time since legalization, they would be able to reliably turn a profit.
3. Significantly more small-to-medium cannabis producers would begin applying for licenses, since now there would be a legitimate path to financial viability.
4. Most of those license applicants would be transitioning from the illicit market, which would greatly reduce the size of that market - helping achieve that stated goal of the Canadian government in legalizing recreational cannabis.
5. Within a few years, the revenue that the Canadian government would receive from the excise duty regime would likely dwarf the current revenue.

Some things to note:

A) The publicly available 2021 Health Canada cannabis statistics show that 37% of Canadians purchased cannabis through illicit channels. However, this data came from a government survey. This means 37% of Canadians were comfortable telling the government that they purchased cannabis illegally. The actual number is quite logically much, much higher than these survey results imply.

B) The Deloitte report shows that the legal cannabis industry has already had huge positive impacts for the Canadian economy. Since legalization, there has been \$29 billion spent on capital expenditures, \$11 billion in legal cannabis sales, and a \$43.5 billion boost to Canada's GDP. Additionally, the legal cannabis industry is directly sustaining 98,000 jobs.

Micro licenses were growing at an exponential rate for the first few years of legalization, but they have now tapered off, since people have realized that it's near impossible to be financially

viable. By altering the excise duty regime and therefore making it easier for small-to-medium businesses to thrive in the regulated market, the rate of new licensees will return to a growth pattern.

If the excise regime is updated to use the same logic used for literally every other regulated industry in Canada, we expect thousands more SMEs to transition, enabling many tens of thousands of additional sustainable jobs, allowing rural communities in Canada to contribute to economic recovery post-pandemic, and increasing Canada's GDP much further.

It would be important to take into consideration that larger standard processors often package cannabis for micro and small standard cultivators. Various provincial governments are actively determining policies to take into account the reality that cultivators rely on processors to access distribution channels, and any excise costs are passed on to the cultivators and both recreational and medical consumers.

We therefore recommend:

1. Remove the \$1 minimum per gram tax per gram, and maintain a graduated percentage on every recreational gram sold for LPs of all sizes. Remove the requirement to charge excise duty on medical cannabis.

2. Tax businesses based on scale, as we see in the Canadian beer industry. This compensates for the substantial economies of scale enjoyed by large producers. Introduce different tax tiers for:

- Micro license holders
- Craft scale standard license holders
- Small to medium enterprise standard license holders
- Large enterprise standard license holders

Thank you for taking the time to read this submission.

Sincerely,



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Kootenay Cannabis Economic Development Council