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Canadian indirect tax news

Update on proposed federal taxation of cannabis products

April 17, 2019

On March 19, 2019, the Department of Finance Canada announced the 2019 Budget, including new measures to address the legalization of new cannabis products in the fall of 2019. These measures include the introduction of three new cannabis product classes and revised excise duty calculation methods, which will apply to the new product classes.

Significantly, new product categories to the legal cannabis market include:

1) Edible cannabis;
2) Cannabis extracts, which will include cannabis oils; and
3) Cannabis topicals.

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The new calculation method for these cannabis products is based on the tetrahydrocannabinol (THC) content of a marketable product, rather than the inputs based method contemplated under the current ad-valorem formula.

The applicable rates for the new product classes are as follows:

Proposed Excise Duty Rates for Cannabis Edibles, Cannabis Extracts (Incl. Oil) and Cannabis Topicals

Province/Territory	Federal Rate ($/mg of total THC)	Additional Rate in Respect of Province/Territory ($/mg of total THC)	Current Ad Valorem Sales Tax Adjustment (per cent)
Alberta	0.0025	0.0075	16.8
British Columbia	0.0025	0.0075	-
Manitoba	0.0025	N/A	-
New Brunswick	0.0025	0.0075	-
Newfoundland and Labrador	0.0025	0.0075	-
Northwest Territories	0.0025	0.0075	-
Nova Scotia	0.0025	0.0075	-
Nunavut	0.0025	0.0075	19.3
Ontario	0.0025	0.0075	3.9
Prince Edward Island	0.0025	0.0075	-
Quebec	0.0025	0.0075	-
Saskatchewan	0.0025	0.0075	6.45
Yukon	0.0025	0.0075	-

Source: Department of Finance

Cannabis oils will fall under the new THC-based calculation regime upon implementation on May 1, 2019, whereas the edibles cannabis, topicals and other cannabis extracts will fall under this regime upon legalization in the fall of 2019.[1]

Insights

The amendments to the excise framework, namely the application of flat-rate duty on the THC content of finished goods, is viewed as a response from the Department of Finance to concerns raised by licensed producers (LPs).

The new THC-based rate is intended to simplify the excise duty calculation for specific cannabis products and ease the compliance burden. For example, the revised calculation method will eliminate the dual compliance burden of tracking inputs to the current ad-valorem duty calculation through complex production cycles and will address the inability to track inputs to cannabis extracts that are sold prior to entry in the duty-paid market. This will also alleviate concerns about the potential disclosure of sensitive commercial information, such as extraction efficiency rates, that could be deduced from required tax information when extracts are sold between LPs.

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[1] Legislation must come-into-force no later than October 17, 2019.

While industry response to the proposed changes has been largely positive, the revised calculation may cause short-term compliance headaches, as LPs will be required to make adjustment to their business intelligence systems to obtain and track the THC/mg as an additional data point through operations.

The proposed changes will apply first to cannabis oils on May 1, 2019, with other products falling under the regime upon legalization. This staggered application will allow industry to make the necessary adjustments to production tracking for cannabis oils and ensure that the necessary compliance structures are in place for the legalization of edibles, topicals and other cannabis extracts in the fall of 2019.

The budget suggests that the THC content calculation will be facilitated through existing labelling regulations under the Cannabis Act; however, the Canada Revenue Agency (CRA) has not confirmed that this is an acceptable basis for the calculation of duties. At this time, it remains unclear as to how the CRA will enforce the THC-based rate with respect to content variances typical of cannabis oils and the new product classes.

While the budget's proposed measures will provide some tax relief to low-THC products typically used for medical purposes, the imposition of the excise duty coupled with application of GST/HST to medical cannabis results in higher prices for medical patients, insurance providers and provincial governments. This ongoing taxation debate suggests the Department of Finance has persisting concerns regarding the diversion of medical cannabis for recreational use.

The absence of any measures to address the taxation of medical cannabis in the budget appears to affirm the position that medical cannabis will be subject to the full tax burden until individual products are assigned a drug identification number (DIN) by Health Canada. The lengthy process and high cost of obtaining a DIN means that tax relief for medical cannabis is unlikely to be around the corner.

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