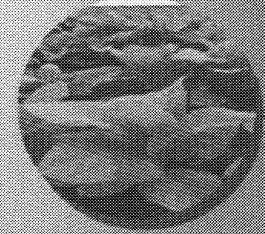




Agriculture and
Agri-Food Canada

Agriculture et
Agroalimentaire Canada



Tobacco Transition Program (TTP)

*Program Objectives, Rules and Audit/Evaluation
Results*

DM Briefing

The design of the TTP

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- The expected outcomes were a free-market environment with a provincial licensing system for the purpose of monitoring where legal tobacco is being grown. (see Annex for results - p. A1 & A2)

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- The FA clearly identifies these objectives (see Clause 2.2 on p. A3).

Established responsibilities between parties

The FA established responsibilities for TTP participants and the Tobacco Board.

Responsibilities of TTP participants:

- Agree not to acquire, rent or obtain any right to produce or market flue-cured tobacco in Canada (i.e. not entitled to a license in Ontario).

Responsibilities of the Tobacco Board:

- Deliver the TTP on behalf of AAFC;
- Remove the quota system and introduce a licensing system; and
- Ensure that no license is granted to a TTP participant or to any person whose relationship with a TTP participant is such that granting a license would undermine the intent of the TTP.

Raised different expectations

- Some were expecting the TTP to shut down production
- Quota holders were expecting that:
 - the TTP assistance be accompanied by provincial assistance like the Tobacco Adjustment Assistance Program (TAAP)
 - AAFC provided the same assistance under the TTP as the 2005 TAAP.
 - In 2005, there were two programs, the federal TAAP and a provincial program. The federal TAAP program contributed \$1.05 per pound of quota and the provincial program provided \$0.69 per pound of quota for disposing of equipment.
 - The August 1, 2008 announcement mentioned that the \$1.05 per pound of quota could be matched 60-40 by the province.
 - no conditions would be placed on the TTP assistance.
 - August 1, 2008 announcement indicated that no conditions would be associated with the program payment
 - Media reported the Minister mentioning 'No strings attached'.

Quota holders found out that:

- restrictions existed for quota holders who participated in the TTP, their spouse, their dependent children and on business arrangements that would undermine the intent of the program; and
- the Province of Ontario decided not to participate.

Attempt at circumventing the rules of the TTP

- In March 2009, media reported that quota holders were transferring quota to non-quota holders prior to participating in the TTP to obtain the payment and continue producing.
- The Tobacco Board was expected to only allow transfers between quota holders.
 - Some transfers were required because of the 4-year moratorium to reorganize businesses, deal with estates, etc.).
- The Tobacco Board was not reviewing transfers and not collecting information for the purpose of issuing licenses.
 - The Board was required to assess whether an individual did or did not undermine the intent of the program.
- AAFC took action, by hiring an auditor to review the Tobacco Board processes and verify all quota transfers.
- The Tobacco Board asked quota holders to rescind all of their quota transfers.
 - Number of quota transfers was reduced from 336 to 22.
 - The remaining 22 transfers were reviewed by the Board and the auditor.
 - Remaining transfers appeared to be legitimate transfers such as the reorganization of a pre-existing business, divorce or the settlement of an estate.

Restrictions introduced created a challenging environment

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Clarifications introduced to respond to the challenging environment

- AAFC developed principles that TTP participants could follow to ensure that their business arrangements with a family member producing tobacco or another tobacco producer would not undermine the intent of the TTP.

Principles for Acceptable Business Arrangements

- Based on income tax approach
- The restrictions hold unless business arrangements are:
 - at arms' length;
 - fair market value; and
 - can sustain an audit.
- The principles were approved by the Minister (Ref. MIN 132787).
- The principles are providing TTP participants with the freedom they need to continue to make a living and/or transfer the farm to the next generation while upholding the intent of the TTP.
- Industry complaints have stopped and some balanced media coverage occurred in late-Spring 2009.

Additional media coverage in 2010

Media have recently been quoting Physicians for a Smoke-Free Canada and reported that:

– **the TTP did not reduce or stop tobacco production**

- However, the purpose of the TTP was not to reduce or stop tobacco production. Media are not going back to the original objectives.

CONSIDERATIONS

- Tobacco continues to be grown in Ontario under the provincial licensing system. Current and future producers are expected to be new producers or those who did not participate in the transition program.
- Canada requires a licensing system to monitor production while tobacco is being grown.
- The Province of Ontario could decide to: restrict who can get a license, or not to issue licenses. (e.g. after the TAAP, Quebec introduced a license system only for the 4 producers who did not participate in the TAAP.)

– **TTP participants are still producing tobacco**

- However, TTP participants are not licensed. Instead, they may rent their land and equipment and may have found work in the industry.

CONSIDERATIONS

- As per the TTP rules which were developed to be consistent with the *Canadian Human Rights Act*, TTP participants can engage in limited business transactions with the holder of a licence to grow flue-cured tobacco, provided that these business arrangements are at arm's length and comply with the intent of the TTP.
- The Tobacco Board established rules on the licensing of tobacco producers to ensure that the program participants are not producing tobacco.

AAFC initiated an audit evaluation in 2010

- Verify the process the Tobacco Board has to issue licenses within the terms of our agreement (recipient audit).
- Verify that business arrangements between TTP participants and licensee are meeting the conditions of the TTP.
 - Selected 56 licensees with 65 declared business arrangements from the 118 licensees.
 - Received information from 53 licensees with 101 business arrangements which were all verified (70% of all the known business arrangements)
 - 48% of the business arrangements were between non-related individuals
- Evaluate if the TTP met its objective of helping quota holders to exit and current producers to be viable.
- Assess the risk that TTP participants produce tobacco through unacceptable business arrangements.

The auditors' findings on the Tobacco Board

- “In general, the processes and controls in place at the Board for the management of the issuance of licenses appear adequate and effective.”
 - TTP Audit Evaluation Report, Samson & Associates.
- The Tobacco Board did not issue licenses to non-eligible individuals or businesses.
- The Tobacco Board could improve the application documentation and verification procedure to capture all business relationships.

Auditor's Recommendations to the Tobacco Board:

1. That the Board clarify the licensee forms to ensure that all relationships are declared.
2. That the Board use the information it has to verify the eligibility of the shareholders of a business seeking a license.
3. That the Board establish a process to collect sufficient data on business arrangements on license applications and after the growing season to confirm that all arrangements are being entered into at FMV.

The auditors' findings on business arrangements

- The audit of 101 business arrangements between Licensees and TTP participants found:
 - Five business arrangements between licensees and TTP participants in 2009 appear not to be meeting the Fair Market Value (FMV) test.
 - One is between non-related parties.
 - There was a lack of information about what can be charged for land, building and equipment rental in 2009 (wages were more similar).
 - This resulted in a wide range of prices and a high net profit for licensees (over \$2,000 per acre).
 - The prices for these inputs are expected to increase now that owners know the profits made by licensees and that their land and equipment are worth more. However the range of FMV should become narrower.
- The auditor determined that the likelihood that non-acceptable business arrangements exist is low.

Auditor's Recommendations to AAFC:

4. Follow-up with the 3 licensees in the audit sample who did not participate in the audit.
5. Determine Fair Market Values for 2010.

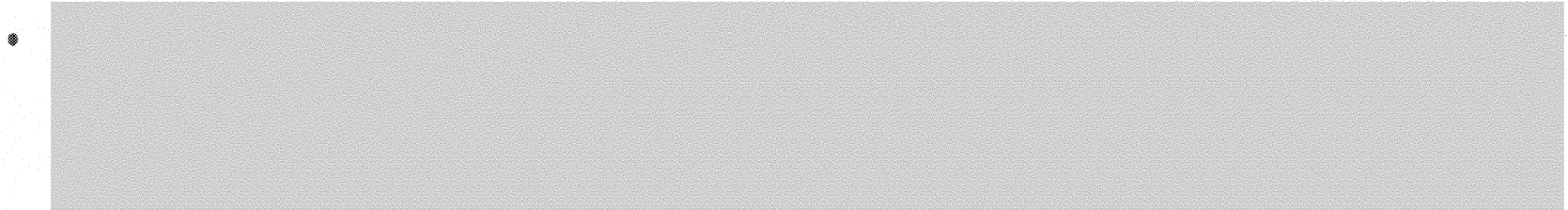
The auditors' evaluation of the program

- The program was successful at helping quota holders exit.
 - In 2009, 74% of the TTP participants who were producing tobacco grew another crop (mainly what used to be their rotational crops).
 - However, this percentage is expected to decline in 2010.
- The program was successful at increasing the viability of producers and facilitating the production of tobacco. The achievement of this objective is more advanced.
 - Profit of licensees increased as they no longer have to incur the cost associated with the quota. This was particularly beneficial to share-growers who had land and equipment, but had been renting quotas for many years.
- Problems understanding the program objectives and communication issues were identified.
 - TTP participants still do not understand why they cannot obtain a license.
 - Anti-tobacco groups do not understand why the TTP did not reduce production
 - General public do not understand why TTP participants can rent their land, equipment, etc. to other farmers, including license tobacco producers.

Findings to be followed-up

- AAFC will write to the Tobacco Board, the Ontario Farm Products Marketing Commission and the Ontario Ministry of Agriculture, Food and Rural Affairs
 - AAFC will share a copy of the final audit report.
 - The Board will be asked to implement the four recommendations and to follow-up on the five relationships which appear not to be at FMV and take appropriate corrective measures if findings are confirmed.

- AAFC decided to expand and extend the audit :
 - audit the three licensees in the original sample who did not provide information to the audit on time.
 - audit additional 2009 and 2010 arrangements and determine the FMV for 2010.
 - Over the next 6 months the auditor will audit an additional 100 relationships.
 - Information on tax statements for 2009 will be available.
 - Information on 2010 will help AAFC and the auditor confirm expected trends for FMV.
 - Will allow for the establishment of 2010 FMV.



Need to report on findings and actions taken

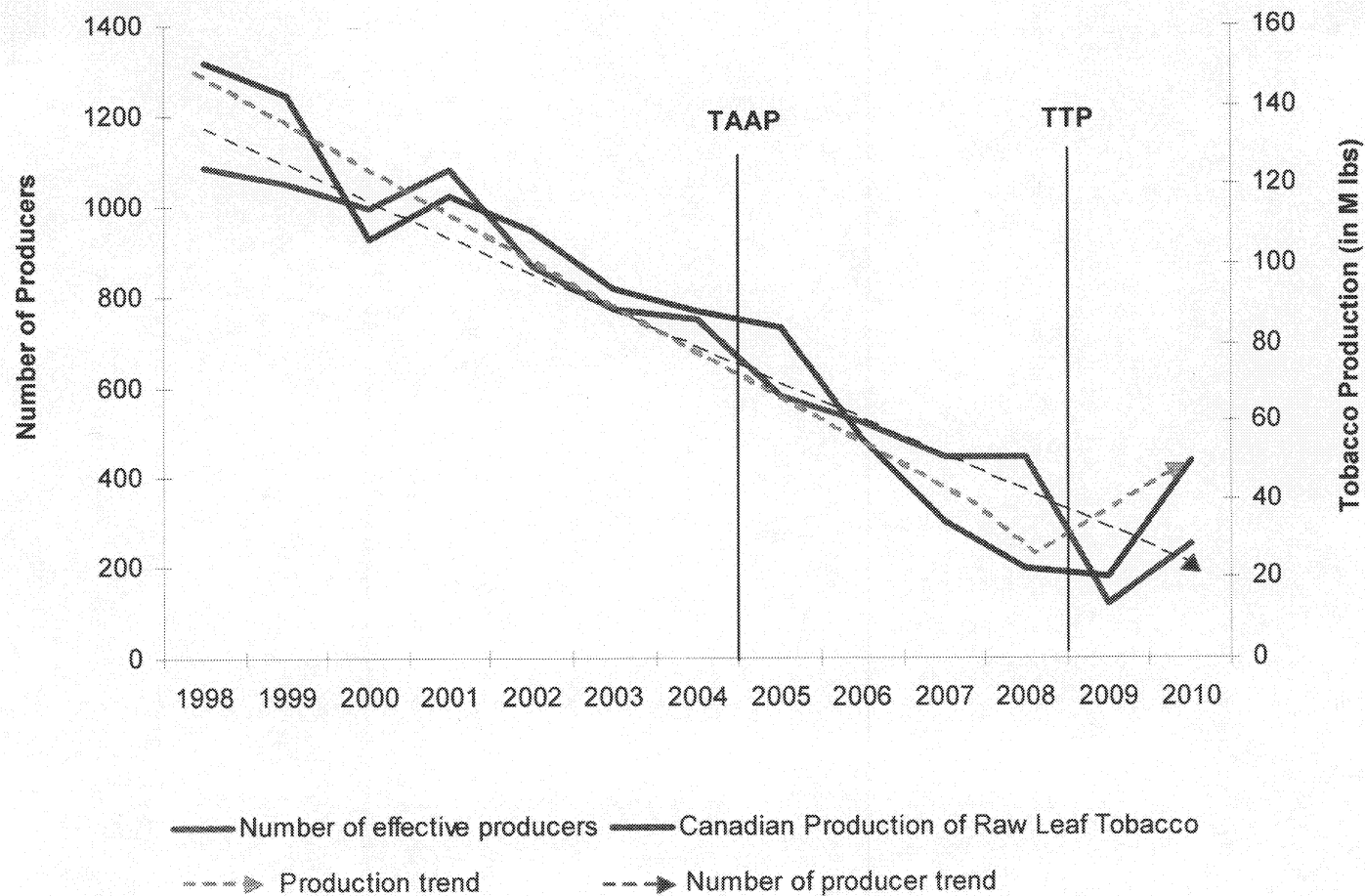
- Communicate that the TTP was found to meet its objectives to remove the quota system, help quota holders exit and help the viability of the industry.
- Communicate that only 5 business arrangements appear not to have fully complied with the rules of the program and the Tobacco Board will be asked to take corrective measures if findings are confirmed.
- Communicate that AAFC is pursuing additional audits to validate the current findings and help the industry determine FMV.
- Communicate that AAFC has asked the province to ensure that the Board implement the recommendations to improve their licensing system .

ANNEX - Results

- The quota system was removed and a provincial licensing system was introduced.
- The TTP retired 270,478,113 lbs of quota (about 99.6% of the quota) and the total cost was \$284,229,440.69.
 - All TTP participants received their payment by May 1st, 2009.
 - Appeals resulted in the cancellation of some applications and the Board owes AAFC \$671,672.
- The remaining quota (0.6M lbs) was mainly held by one individual who did not apply to the TTP (to stay in the industry).
 - All quota disappeared with the implementation of the provincial licensing system.

ANNEX - Production Trends

- The number of producers has been reduced and the viability of the industry was enhanced with fewer producers producing larger crops.
- Canadian producers will increase their share of the Canadian market.



ANNEX – Funding Agreement Clauses

2.2 ***Expected Results*** The expected results of this Agreement are:

- 2.2.1 the removal of the quota system for the control of production and marketing of Tobacco and the implementation of a licensing system through the enactment of necessary regulations by March 31, 2009 that does not limit the quantity of Tobacco that may be produced by a licensee or its marketing for lawful purposes and will complement existing controls on tobacco in the federal *Excise Act, 2001* and existing, or other, Government of Ontario regulations affecting tobacco; and a commitment by the Board not to subsequently reintroduce a quota system for the production and marketing of Tobacco;
- 2.2.2 an easier transition of producers out of the Tobacco-growing industry by making payments to Eligible Recipients who agree to participate in the TTP; and
- 2.2.3 improved viability of remaining and future Tobacco producers who will produce Tobacco under a licensing system in Ontario.

ANNEX – Restrictions & Considerations

Main MINO's Restrictions	Legal Considerations	Policy Considerations
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