

# UPDATE: ONLINE GAMING REFORM IN THE UK

By Julian Harris and Tom Grant

We do not yet know whether the forecasts that the gross gaming yield for the online gaming industry in the U.K. of £2.28 billion in 2013 were accurate or not. For the future, estimates indicate that online sports betting alone will continue to rise during this World Cup year with net gaming revenues set to break the £1 billion barrier by 2015. It is hardly surprising, therefore, that the long-awaited changes to the United Kingdom's comparatively liberal online regime will take effect later this year, pursuant to which all remote gambling operators targeting the U.K. market will be required to hold a license from the U.K. Gambling Commission. For the online gambling industry, these changes will have major ramifications.

The draft Gambling (Licensing and Advertising) Bill proposes fundamental changes to the basis upon which remote gambling is regulated in Britain by amending two key provisions of the Gambling Act 2005: Firstly, it will become a requirement to hold a U.K. operating license in order to provide gambling facilities to customers located in Great Britain, and, secondly, it will become a requirement to hold a U.K. operating license in order to advertise gambling facilities in the United Kingdom (Great Britain and Northern Ireland). A further key change is to be effected by the Finance Bill pursuant to which it will become a requirement to pay U.K. remote gambling duty, currently at 15 percent of gross gambling profits (stakes paid, less any winnings paid out), on all transactions with customers whose normal place of residence is in the United Kingdom.

The bill was expected to pass into law sometime around May 2014, giving operators approximately three months to prepare for a new licensing regime. There will be a two-month period between the bill obtaining Royal Assent and the acceptance by the commission of operating license applications and then just more than one month before the new licensing regime goes live. There will be a transitional period for EEA and white-listed operators to continue operating pending determination of their operating license application, which must be made during a monthlong application window. The application window will be followed by a one-week "dead period," during which the commission will process last minute applications. Following this week, the new regime will go live. The transitional arrangements will be the subject of a statutory instrument that is yet to be published.

All new U.K. licensees will become subject to the provisions of the Gambling Act 2005, its regulations, and the commission's social responsibility and technical standards requirements. These requirements will take immediate effect upon the new licensing regime going live, regardless of when the operator's license application is ultimately determined. In this regard, operators who are beginning their research now should note that the commission is currently consulting on significant changes to the license conditions and codes of practice, most of which are intended to come into effect concurrently with the new license requirement. Operators will need to implement new operating

policies and procedures and have software and equipment re-tested against the U.K. standards. This is likely to involve a "gap analysis" in relation to testing already undertaken. Depending on the demands of an operator's current regulatory regime, the cost of compliance may be high. It may be of some comfort that those operators currently licensed in white-listed jurisdictions are likely to be subject to a lesser degree of scrutiny as the commission accepts that they are already highly regulated and may be permitted to retain their remote gambling equipment in its current location.

From a commercial perspective, operators will also need to assess how their end user terms, and conditions will need to be varied to reflect the requirements of the new license conditions and codes of practice. One possible complication here is how conflicting licensing requirements will be reconciled. For example, an operator's existing license may require a certain approach to matters such as dispute resolution and segregation of customer funds that may not necessarily reflect those that will be required by the commission's revised LCCP. Operators will, therefore, have to consider how they ensure that their U.K. customers are governed by terms consistent with their new U.K. licenses. It may even be the case that operators will have to ensure that customers are linked to a specific set of terms and conditions consistent with the requirements of the jurisdiction in which they are registered.

## Changes to Basis of Taxation

Running concurrently with the changes to the Gambling Act 2005 are proposed changes to the basis for taxing remote gambling operators targeting the U.K. The draft bill alters the current tax position so that it will only be those U.K. licensees who choose (or are required by the commission) to locate their equipment in Britain who will need to begin paying U.K. tax upon implementation of the changes to the basis for licensing. The bill does not automatically bring all remote gambling operators within the U.K. tax requirement simply because they will need to hold a commission license.

There is, therefore, likely to be a short "grace period" between the expected implementation of the bill and the expected implementation of the tax requirement at the end of 2014, during which new U.K. licensees will not be required to pay U.K. remote gambling duty, unless they have remote gambling equipment in Great Britain.

In August 2013, the DCMS published a summary of the responses received to a consultation on the way the new tax requirement should be effected. A key conclusion in this document relates to the basis for determining whether a person with whom an operator is transacting is a U.K. customer.

The government has recommended that the customer's usual place of residence will be the basis for determining whether remote gambling duty is payable. If a U.K. customer is on holiday overseas, remote gambling duty will still be payable on their transactions; however,

operators will not require a U.K. license to transact with them. On the other hand, if a foreign customer is on holiday in the U.K., a license will be required to transact with them but remote gambling duty will not be payable on their transactions. The basis for licensing in the current draft of the bill is still under consideration, but the commission supports the current draft on the basis that all those physically present in the U.K., whether they are here as a resident or a visitor, should be subject to the protection afforded by gambling with a licensed operator. As it stands, the requirement for a license will be based upon the location of the customer whereas the requirement to pay tax will be based upon the usual residence of the customer.

**How Will the New System Be Enforced?**

The government does not currently intend to introduce any new enforcement measures to support the new license and tax requirements, despite an estimate by the Treasury that up to 20 percent of remote gambling duty due on transactions with U.K. residents will not be paid. DCMS does not accept that a similar figure can be applied to the amount of play that will be on sites which have not obtained a U.K. license, stating at the committee hearing on Nov. 12, 2013, that “the enforcement gap is not necessarily the same as the Treasury’s assessment of a taxation gap,” but DCMS has not made any assessment of its own as to what the enforcement gap might be. However, it is difficult to see how any U.K.-licensed operators will avoid paying U.K. tax. The different basis for licensing and taxation (whether a player is located in Great Britain or normally resident in the U.K. respectively) accounts for some discrepancy in the transactions that will be licensable/taxable but we anticipate that, for the most part, transactions that take place under a U.K. license will be subject to U.K. remote gambling duty.

In reality, the commission and the police would be unlikely to be able to issue proceedings against an operator breaching the law from overseas, due to the difficulties of extraditing offenders, although it is possible that key personnel of an overseas operator that has breached the law could be arrested upon entering the U.K. If either a significant enforcement or taxation gap does appear to be a problem once both the license and tax requirements are in force, we would expect the government to revisit the possibility of introducing ISP or financial transaction blocking mechanisms.

**Outstanding Issues**

The implementation of the new licensing regime brings with it a number of issues that remain unresolved:

**1. White label agreements**—In relation to “white label” arrangements, an argument exists that a company that provides its branding to and advertises a gambling site it has commissioned a third party to operate “invites others to gamble in accordance with arrangements made by him.” However, we have recently had confirmation from the commission that it is not seeking to license both parties to the agreement if they are not currently both licensed, even though they might be caught by the wide definition of “providing facilities for gambling.” The commission considers that, in accordance with current arrangements, only the party operating the gambling facilities will require a license and not the party providing its branding and marketing the gambling services.

**2. Business to business arrangements**—Where gambling services are provided under an agreement between a “business to business” operator and a “business to customer” operator, the commission has confirmed that both parties would require a full remote gambling operating license. However, the commission has stated that compliance with the license conditions, codes of practice and

technical standards could be “carved up” between the two operators. How this will work in practice and what impact it will have on existing contractual arrangements remains to be seen, and, initially, there is scope for some confusion here.

**3. Software providers**—The commission intends to introduce a new license condition requiring operators to ensure that all companies providing them with gambling software hold a U.K. software operating license. It is not clear how far down the supply chain this license requirement goes. For example, if an operator is supplied with software from a company that itself outsources part of the development, must the operator ensure that the company to which development is outsourced is also licensed? Operators will also need to consider the commercial implications of this proposal and what impact it will have on their relationship with suppliers, customers and end users. For example, while existing supply agreements may contain a general requirement for software providers to comply with all applicable licensing conditions, this is not guaranteed, and operators will need to ensure that such providers are properly licensed and are operating in accordance with U.K. testing requirements. While this may not require extensive commercial negotiations, operators may need to carry out a full audit of their contractual supply arrangements and, where necessary, agree addendums to reflect the new requirements. For the time being, clarification from the commission is awaiting on this point. The commission has indicated that it does not intend to add this new license condition until sometime after the bill comes into force and operators obtain their U.K. licenses, thereby giving operators and suppliers time to comply.

**Next Steps**

Although all existing white list and EEA operators will be entitled to a transitional license, the commission will be considering all applications in the usual way and will only grant a full operating license if it is satisfied the operator is suitable to carry out the licensed activities in line with the licensing objectives. The timeframe for preparing an application will be tight as the commission intends to invite applications two months after the bill receives Royal Assent.

All operators should be preparing the necessary policies and procedures to accompany their application now, as well as determining what changes will need to be made to their software and equipment to bring them in line with U.K. requirements.



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