

Changes coming to the U.K. online gaming market

Top legal experts in the U.K. preview tax and regulatory changes to Europe's most important market



By Melanie Ellis and Harris Hagan

It is only just over four years since the U.K.'s Gambling Act 2005 came into force. But the U.K. is already considering regulatory changes to its thriving online gaming market. The fact that the government is already proposing to change its provisions in relation to online gambling is testament to how rapidly the gaming industry, and the way it is regulated, is changing.

In the next few years we believe it is inevitable that online operators targeting the lucrative U.K. market will be forced to obtain a U.K. license, which comes with the key drawback of the requirement to pay 15 percent duty on gambling revenue from U.K. residents. While operators are likely to have a couple more years' respite

due to the need for Parliament to debate primary legislation to effect the change, they should prepare for this requirement to come into force in the medium term.

The online market

The 2005 Act introduced a regulatory regime for online gambling for the first time in the U.K., and the U.K. was one of the first jurisdictions to issue online licenses. Of course Internet gambling had been around for a decade already, but no one has ever accused the law of being ahead of its time.

The U.K. is an attractive market for online gambling operators, with 11.9 percent of the population participating in some form of remote gambling. While remote

gaming and betting duty at 15 percent of gross gambling yield combined with U.K. corporation taxes make the U.K. an unattractive home for online gambling operators, the fact that operators are permitted to target the U.K. from low-tax "white list" jurisdictions means it has been a lucrative market. The Gambling Commission estimates that 75 percent of remote gambling carried out by U.K. residents is with operators located overseas.

Rather optimistically, the 2005 Act was intended to be a modern and flexible piece of legislation, if not completely future proofed. The legislation does allow for the regulation of new forms of gambling which were not envisaged at the time it was drafted, such as social media gaming, even though this does sometimes require careful legal interpretation. By introducing wide



definitions of concepts such as “remote gambling” (any gambling by which persons participate by means of remote communication), “game of chance,” “betting” and “betting intermediary,” it is possible to license just about any gambling concept which can be envisaged, on any kind of remote platform, provided the Gambling Commission can be persuaded as to which license is appropriate and there are no regulatory concerns.

What was not legislated for was the fact that the rest of Europe would not follow the U.K.’s lead in terms of the basis on which remote gambling is licensed and regulated. With hindsight, this was rather naive, as the U.K. is often at odds with the rest of Europe – unfortunately when it comes to online gambling, David Cameron does not have a veto to exercise!

What has changed?

In the last few years, European jurisdictions (notably Italy, France, Spain and Denmark) have begun introducing regimes for the licensing of online gambling on a “point of consumption” basis. At first this idea was controversial. Commentators argued that the European Treaty’s provisions on the free movement of goods and services meant that a gambling operator based in one jurisdiction should be entitled to allow customers throughout the European Economic Area to participate in its games, and to advertise to those customers as well. Indeed, this is the basis upon which the U.K.’s Gambling Act is currently drafted: operators based in EEA (and also selected “white list”) states are entitled to advertise their services in the U.K. The U.K. magnanimously acknowledges that it does not have a monopoly on good regulation. Further, there is no restriction on the jurisdictions from which operators may accept U.K. customers.

However, European Court of Justice rulings and the results of infringement proceedings in the European Commission have led to the position that member states have discretion as to how they choose to regulate online gambling, and may legitimately introduce national licensing regimes where operators are required to obtain a local license in order to target the market. Fortunately, from an industry perspective, it is still not acceptable to maintain a state monopoly

system unless this can be justified on public-interest grounds and gambling is restricted in a way that is consistent with these objectives.

Given the U.K.’s failure to attract a single major online gaming operator and the substantial tax revenue which flows from a requirement to hold a local license, it is no surprise, at least from a political perspective, that the U.K. should now seek to amend its legislation to regulate gambling on the same basis as others in Europe.

Regardless of the developments in Europe, it could be said that the Gambling Act 2005, as drafted, was doomed before it even came into force. As soon as the Treasury set the rate of gaming and betting duty at 15 percent, allied with an ability to target the U.K. from offshore, it became apparent to operators that to remain in the U.K. would put them at a disadvantage as compared to those based overseas.

What changes are proposed?

In April 2009, the government announced that it would explore ways to “level the playing field” for U.K. operators. One of the options proposed was to require overseas operators to contribute to the cost of regulating gambling in the U.K.

When the review of the 2005 Act was first mooted over 18 months ago, it was unclear how a level playing field could be achieved without introducing some form of U.K. license requirement. By January 2010, proposals for a license requirement were announced and the government’s reasoning had evolved from enabling U.K. operators to be competitive, to protection of U.K. players. The government cited concerns as to the inconsistency of regulatory standards across Europe; indeed the Act allows operators based anywhere in the EEA to advertise in the U.K. even if there is no regulatory regime at all in their home jurisdiction. The consumer protection angle reflects the basis on which other European jurisdictions have introduced “point of consumption” licensing regimes and perhaps also makes the legislative changes more palatable to Parliament and the British public.

The government’s stated reasons for proposing to switch to a “point of consumption” licensing regime do not relate to the projected tax revenues. This is unsurprising because the introduction of a new licensing regime to increase tax revenues would contravene EU law. However, the extent to which DCMS and Treasury are working in tandem on the proposed reforms is revealing.

Following a consultation period, in July 2011 the government announced that the U.K. license requirement would definitely be introduced, although any indication of a timescale for the changes is still awaited. We now know that in the future all gambling operators advertising their services in the U.K. or contracting with U.K. customers will need a license from the U.K. Gambling Commission. Although the government does not propose to introduce enforcement measures such as ISP blocking, unless it proves necessary and the requisite technology improves, we anticipate that it will become almost impossible to advertise unlicensed gambling services in the U.K. The media will be aware that they may only accept advertisements from U.K.-licensed operators; otherwise they may be committing a criminal offense. It is probably true to say that the government is focusing on the low hanging fruit; the majority of U.K. bets are placed with large, reputable operators (many of them plcs) which will have no alternative but to comply with the law.

John Penrose MP, the U.K.’s gambling minister, has recently reiterated the government’s intention to introduce these amendments to the 2005 Act. This indicates that momentum is building for these changes; however, primary legislation is required and (fortunately for the industry) the reality is that due to a lack of legislative time to debate the changes and hold further consultation, it is unlikely that the license requirement will come into force for at least another couple of years.

What does this mean for operators?

Taxation and license fees

The obvious and perhaps most significant implication of the change will be that all



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operators transacting with U.K. players will be required to pay U.K. remote betting or gaming duty at 15% of gross gambling yield. Operators envisaging moving their base from a zero or low gaming tax jurisdiction (such as Alderney, Gibraltar or the Isle of Man) will previously have been concerned about the fact that a U.K. license came with a requirement to pay the duty on all transactions conducted under that license, not just transactions with U.K. residents. However, some relief will have come with the recent announcement that the U.K. is moving to a "point of consumption" basis for taxing online gambling, as well as for licensing it. In other words, U.K. licensees will not have to pay gambling duty on bets placed by non-U.K. residents. The change to the basis for taxation will come into force in April 2012, so current U.K. licensees can begin enjoying this benefit almost immediately.

As well as U.K. gaming duty, operators will need to budget for the annual licensing fees payable to the Gambling Commission. However, license fees in the U.K. are fairly reasonable compared to

other jurisdictions, particularly for those operating on a smaller scale. For example, a license for casino games (including poker), where annual gambling revenues are between £550,000 and £5 million, is subject to an annual fee of around £9,500 per year. A license for remote fixed-odds betting on real events will cost around £13,500 per year, provided revenues do not exceed £5.5 million. In addition to remote betting duty, licensees accepting bets on horse races in the U.K. will also need to factor in the duty payable to the Horserace Betting Levy Board, at 10.75% of gambling yield.

Currently, it is not necessary for a U.K. license application to be made by a U.K. company. This does not necessarily mean that U.K. corporation tax (26% of profits) can be avoided; however, careful corporate structuring may be able to minimize the impact of this tax. Detailed consideration of this issue is, however, beyond the scope of this article!

Server location

As the law stands, all U.K. licensees are required to locate at least one piece of remote gambling equipment in the U.K. The Gambling Commission tends to work from a starting point that all equipment will be in the U.K., but it does have discretion to allow equipment to be located overseas. It is unlikely to exercise this discretion unless the location in question is a well-regulated gambling jurisdiction where it can communicate with the local regulator and effectively monitor the equipment in question.

No announcement has been made on this subject, but it may be that in amending the Gambling Act the government removes the requirement for any equipment to be located in the U.K. This would certainly make the transition to a U.K. license easier for companies with established operations overseas. It may also affect corporation tax considerations.

Application process

When the U.K. license requirement is introduced it is very likely that some form of transitional arrangements will be put in place for operators currently targeting the U.K. from EEA and white list jurisdictions. This will allow such operators to continue their U.K.-facing operations for a period, perhaps six

months, pending full determination of their U.K. license application.

Operators should be aware that a U.K. license application will entail a rigorous investigation by the Gambling Commission into the affairs and financial circumstances of the main shareholders in the applicant company, as well as companies further up the chain of ownership. Those in key management positions will also be subject to investigation. This process can take up to six months to complete for larger companies, although typically a U.K. license application can be completed in under three months.

The Commission will adopt a bespoke, risk-based approach to online gambling regulation. Particularly when it comes to licensing those currently operating from reputable jurisdictions, this means that it has the flexibility to carry out a more or less rigorous investigation depending on the home jurisdiction, scale of operations and operating history of the applicant. The Commission will wish to avoid duplication of work already undertaken by the home regulator and will have considerable flexibility around the conditions to be imposed on licenses to achieve its objectives.

How will the market change in practice?

It appears unlikely that companies will relocate employees to the U.K., not least because there will be significant tax advantages to retaining as many ancillary services as possible overseas. Assuming that operators will be entitled to retain gambling servers overseas as well, the most significant differences to operators will be the requirement to pay U.K. license fees and gambling taxes and of course the fact that they will be regulated by the U.K. Gambling Commission.

As all operators targeting the U.K. will be subject to these same costs, it may be that the impact of the change on the industry is less than anticipated. Ironically, it is likely to be the customers who most feel the impact, as additional costs to the operator means fewer bonuses and incentives will be able to be made available. We doubt the customer will see this as a price worth paying for questionably greater regulatory protection.

