

U-Turn for the UK

by John Hagan and Melanie Ellis

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A year ago, the UK's Department for Culture, Media and Sport ("DCMS") decided to review the current system for regulating online gambling with the aim of "creating a level playing field" for UK based operators. A consultation document has now been published, recommending drastic changes – most notably removing the right for operators in the European Economic Area (EEA) and white listed jurisdictions to advertise freely in the UK without a UK licence. It is proposed that these operators be required to hold a UK licence to advertise in the UK or transact with UK customers, making them subject to the same standards of regulation. Although any discussion of the tax implications of these changes is absent from the consultation document, the elephant in the room is the extent to which affected operators will be subject to the UK's gambling taxes.

Background

Under the current regime, only operators with "remote gambling equipment" located in Great Britain are required to hold a UK operating licence. It is, however, worth noting that as a result of the Gambling Commission's liberal interpretation of what falls within the definition of remote gambling equipment, it is possible for operators to locate facilities such as call centres and banking in the UK without the need for a UK licence.

It is an offence to advertise remote gambling services in the UK without holding an operating licence, but an exception exists for operators subject to the laws of an EEA state, Gibraltar or a white listed jurisdiction. These operators are currently permitted to market their services to the UK without holding a UK licence. As UK licensed operators are subject to a tax on gross gambling profits of 15%, the majority of operators targeting the UK take advantage of the exception and are based overseas. Most remote gambling websites used by British players are, therefore, not licensed in the UK.

A large proportion of the websites that are advertised in the UK and accessed by British consumers are licensed and regulated in Gibraltar, Malta or the white listed jurisdictions of Alderney and the Isle of Man. Regulatory standards in these jurisdictions do not appear to be a cause for concern for the UK Government. However it is certainly troubled by the lower standards or even complete lack of regulation in other jurisdictions permitted to advertise to the UK, in particular emerging European jurisdictions where there may not be effective systems of regulation in place.

The Government acknowledges that no specific public protection issues have yet arisen, yet it feels that the potential threats to the licensing objectives are sufficient to recommend in the consultation document that all operators come under the supervision of the UK Gambling Commission.

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Taxation

The consultation does not address the issue of taxation at all, as this is a matter for HM Treasury, not the DCMS. But operators affected by the proposed changes will, of course, be keen to assess the full financial implications. Unfortunately, we see it as very likely that the 15% tax on gambling profits will apply to all operators obliged to obtain a UK licence under the new system. The UK government is not seeking to attract new operators to the UK with these new proposals, rather it intends to force all those currently operating in the UK market to become regulated here. Also, politically it would be unacceptable to lower the rate for online operators but retain it for land based ones.

We therefore do not expect to see a lower tax rate being introduced in conjunction with these changes. The lack of 'joined up thinking' from the Government brings back memories of the introduction of the 15% rate when the 2005 Act first came into force. The aspirations of DCMS to make the UK the new home of online gambling were killed at the last minute by the Treasury's decision to set this rate of taxation. Some might say it was inevitable that the provisions of the Act would need to be amended following the introduction of a tax rate which would put most operators off becoming licensed in the UK.

That said, it is worth bearing in mind that, although much criticised, the UK's gaming tax rate is lower than other emerging jurisdictions such as France and Denmark. These countries realised from the outset, however, that higher taxation for operators must be combined with a requirement that they be licensed in that jurisdiction. It is not inconceivable that HMRC may consider a lower rate in the future if it is demonstrated that this may lead to higher revenues overall, but operators should proceed on the basis that the rate will be 15%.

Recommended options

The key recommendations in the consultation document are:

- (1) in relation to all operators, whether in white listed jurisdictions, EEA member states or Gibraltar, to introduce a requirement to obtain a licence authorising them to transact with British consumers and advertise in the UK; and
- (2) to develop a more streamlined white listing process for adding new non-EEA jurisdictions to the list.

If these recommendations are to be implemented, changes to the Gambling Act 2005 will be required. Notably, a new offence of transacting with British consumers without holding a UK licence will need to be introduced in addition to the existing offence of advertising in the UK.

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The proposed definition for this new offence would cover any gambling transaction between an operator and a person “ordinarily resident in Britain”, which would include any person registering with a British residential address, bank account or IP address. This is a wide definition, and would include both British residents while travelling overseas (who register using their British address or bank account) and foreign individuals registering while visiting Britain (due to the British IP address).

Operators based outside the UK, Gibraltar, the EEA and white listed jurisdictions are not currently permitted to advertise in the UK. However these operators are allowed to transact with UK customers under the law as it stands. Although the effect of the proposals on such operators is not specifically addressed in the consultation, the new offence of transacting with British consumers will mean that they will have to obtain a UK licence to comply with the law.

However, it is not intended that this offence will have extra-territorial effect, on the basis that this would be disproportionate in relation to the likely harm caused. We do not envisage enforcement action being taken where operators are not actively targeting UK residents.

Implications for operators in white listed jurisdictions

If a UK licence is to be required for all operators, it might be questioned why the white list is being retained at all. The advantages of being licensed in both a white listed jurisdiction, such as Alderney or the Isle of Man, and the UK are as follows:

- These jurisdictions offer low or non-existent rates of corporate tax
- If the UK is not the only target market, operators will not wish to have all their transactions subject to UK gambling tax
- For those targeting other jurisdictions, Alderney, for example, offers a business to business licence for the gambling platform, which can be used in conjunction with a French customer facing licence
- Less onerous conditions may be applied by the UK Gambling Commission as the operator is already subject to a high standard of regulation

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- The UK licence application process may be faster, as the Gambling Commission can rely to a certain extent on checks already conducted by the local regulator

The consultation document envisages that operators will be permitted to retain key equipment, staff and other functions in a white listed jurisdiction, and the Gambling Commission will work with the regulator in relation to compliance activities. It is hoped that reciprocal arrangements can be agreed with local regulators, enabling them to conduct compliance visits and report back to the Commission.

Bespoke licensing regime

In recognition of the fact that UK licence applicants will include those established in existing white listed jurisdictions or well regulated European jurisdictions, those currently operating from less well regulated jurisdictions and start up operators, it is proposed that differing requirements will be imposed on these applicants. The Government intends that the Gambling Commission will employ a 'bespoke approach' when determining the conditions that will be imposed on licensees. Under the current system, a standard set of licence conditions are imposed on most (if not all) operators. Deciding which conditions to impose on a case by case basis will impose a significant burden on the Commission and the possibility of a resulting increase in licence fees is a legitimate concern.

The consultation document envisages that the Commission may consider including licence conditions requiring some operators to have a UK company, a representative in Britain and/or to locate certain parts of their operation and key equipment in the jurisdiction. These factors would impose additional costs on operators, but the key concern is whether they become liable to UK corporate tax. For those operators currently based in white listed jurisdictions, we hope that such requirements would not be imposed.

Fees

Although the requirement to pay UK tax is likely to be the main financial concern for operators, they will also wish to budget for the fees payable to the Gambling Commission. An initial application fee is payable, and subsequently an annual fee. The level of these fees varies depending on the type and scale of operation. By way of example, a remote casino or bingo operator with annual gross gambling yields of between £0.5m and £5m would pay an application fee of around £7,000 and an annual fee of around £10,000. A remote betting operator accepting bets on real events, with annual gambling yields of between £5.5m and £110m would pay an application fee of around £7,000 and an annual fee of around £38,000.

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The highest category licensees - those offering casino games, bingo or betting on virtual events with yields of over £500m per year - attract an application fee of around £64,000 and an annual fee of around £155,000.

The consultation considers whether fees might vary for operators based in different jurisdictions, with those causing disproportionate levels of work for the Commission (for example due to operations being spread over multiple locations) paying more.

Enforcement

We anticipate that all reputable operators currently targeting the UK market will, of course, wish to apply for the appropriate licence. In considering its enforcement strategy, the Government recognises that it would be smaller operators with significantly less impact in the UK market who are more likely to commit the offences of advertising to and transacting with British consumers without holding a licence.

As mentioned above, it is not intended that these offences will have extra-territorial effect. The Government takes the view that extradition would be disproportionate to the harm caused, given the resources and diplomatic sensitivities involved. Nor is it proposed to make it an offence for British residents to gamble with an unlicensed operator, as again the Government believes this would be disproportionate to the harm caused.

It is worth noting that the legislation currently allows the Commission to prosecute British companies involved in advertising foreign gambling, such as broadcasters and publishers. This would remain an effective deterrent for the media to carry advertisements for unlicensed operators. With a requirement for all operators to hold a licence from the Gambling Commission before being entitled to advertise in the UK, it will be a simpler task for the media to check on the Commission's database whether they can accept advertisements from an operator.

The Government has also considered whether to introduce Financial Transaction Blocking and/or ISP blocking to enforce the new system. In relation to both measures, it was found that the evidence of their effectiveness was mixed. Taking into account the cost implications of introducing these measures, the Government feels that they would not be appropriate at this time. It may be the case, however, that changes to the Gambling Act are included which would allow these measures to be introduced in the future if it proves necessary.

Non-remote overseas operators

Whilst looking at possible changes to the advertising of remote gambling in the UK, the Government has also considered changing the rules regarding the advertising of overseas non-remote gambling such as overseas casinos and poker tournaments.

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Currently, this falls within the same rules as the advertising of remote gambling: only gambling taking place in EEA or white listed jurisdictions may be advertised in the UK. In particular, the Gambling Commission has expressed the view in an advice note that offering a prize of a seat at an overseas poker tournament such as the World Series of Poker would constitute an offence.

It is now felt that, due to the fact that a customer would need to travel outside Britain to participate in the gambling being advertised, it may not be appropriate for this to continue to be an offence. The Government is, therefore, consulting on whether to permit non-remote foreign gambling to be advertised freely in the UK.

There would be positive and negative implications for non-remote operators in the UK. The consultation document envisages that this change may enable overseas operators to provide direct competition to UK-based operators, without UK operators enjoying reciprocal advantages of being able to advertise their own services in these jurisdictions. However, UK operators, in particular casinos (both online and offline), may welcome the option to now offer prizes such as a seat at the World Series of Poker.

Practical implications

The Gambling Commission has produced an estimate that around 75 overseas operators will be affected by these proposals. In view of the fact that all operators currently accepting UK customers will be affected, not just those in white listed and EEA jurisdiction, we believe this estimate is too low. We would expect significantly higher numbers of operators to be seeking a new licence when these proposals come into effect.

The main practical implications for operators are the need to comply with the Gambling Commission's licence conditions and codes of practice and technical standards, which will differ in varying degrees from the standards currently adhered to by different operators. Operators must also submit quarterly regulatory returns to the Gambling Commission, giving details of compliance, revenue and any suspicious activity.

Timing

From our experience of such consultations, barring any unexpected responses we see it as highly likely that the recommended options will be implemented. A new Government after the general election on 6 May could delay the changes coming into effect, but we do not see it as likely that the proposals will be scrapped by whichever party comes into power.

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The Government proposes a further full consultation with the industry to work out the details of how the new system will work in practice. This will further delay the implementation of the proposals, and in our view they are likely to come into force in 2011 rather than 2010. The exact timing will depend on legislative priorities and could be sooner than this, but realistically we are expecting the changes to come into force in the next 12 to 18 months. Operators should, therefore, proceed on the basis that a UK licence is very likely to be introduced as a requirement next year. In our view, it would certainly be worth beginning to bring systems, policies and compliance procedures in line with UK requirements and budgeting for the costs of UK licence fees and taxes.

Final thoughts

Although DCMS is seeking views from the industry in this consultation exercise, past experience tells us that we should count on the recommended options being adopted. We therefore expect it to become a requirement for all operators targeting the UK to hold a UK licence next year. This move is not unexpected, however. Emerging European jurisdictions such as Italy, France and Denmark all require local licence fees and taxation to be paid if their residents take part in online gambling.

Accessing the lucrative UK online gambling market is about to get much more expensive. Gambling Commission fees and, more importantly, UK remote gambling tax at 15% of gambling profits will hit operators hard. Looking for a bright side, however, the fact that all operators will be subject to the same requirements means that no operators are disadvantaged as compared to their competitors. Perhaps it is UK players who will suffer the most after all, as none of their favourite sites will be able to offer bonuses and incentives at the same levels as before. A high price to pay for the Gambling Commission's 'protection'?

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