

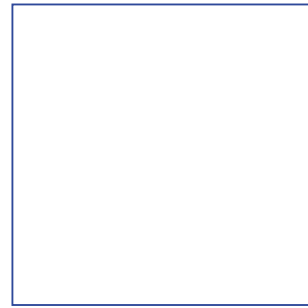
chapter thirty six

The Business Environment

- 36.1 This chapter considers the relationship between our proposals and the requirement in our terms of reference that we should have regard to
- the desirability of creating an environment in which the commercial opportunities for gambling, including its international competitiveness, maximise the UK's economic welfare; and
 - the implications for the current system of taxation and the scope for its further development.
- 36.2 Our general approach in this report has been to concern ourselves mainly with the interests of the punters – the consumers of the services provided by the gambling industry. We believe that these interests are best met by allowing (adult) gamblers the maximum freedom of choice consistent with keeping the industry free of crime and protecting the vulnerable. We have sought to expand their choice by, among other things, proposing the removal of the permitted areas rule as it applies to casinos and bingo halls and the demand test as it applies to casinos, bingo halls and betting shops. We hope that the result will be greater competition between those who seek to provide gambling services. That is one of the means by which we believe that the UK's economic welfare will be maximised.
- 36.3 The consumer benefits from competition whether it be met by UK or overseas companies. It has not been our objective to seek to maximise the profitability of UK companies. That would be completely contrary to the spirit of free trade which also allows UK companies to prosper in overseas markets. We believe that much of the UK industry has a well-deserved reputation for efficiency, innovation and honesty which provides it with excellent opportunities to succeed here and elsewhere. What is important is that UK suppliers should not face disadvantages in competing with foreign suppliers. There are two areas in which disadvantage could arise: the first is taxation and the second is regulation. Both have become more problematic with technical change, particularly in relation to the internet.

Tax and the punter

- 36.4 The punter can choose between various types of gambling and between different suppliers of the same type of gambling. As we described in chapter 16, one can think of the gross gaming yield (the difference between the stake and the payout) as the price of a particular type of gambling. The higher the gross yield the higher the price (per £ staked). The gross yield is made up of costs, profits, taxes and any contributions to good causes or the underlying sport. Normally the punter will neither know nor care what the individual elements are. He will know, if he is interested, that the payout on table games, for example, is on average 97.5% of the stake; but he will not care how much of this is profits, how much is costs and how much is tax. The main exception to this general rule is the current system of general betting duty, which we discuss below.
- 36.5 Figure 36.1 shows the current position. It can be seen that specific taxes on gambling are levied either as a proportion of the stake, as a proportion of the gross margin or as a duty on the equipment used. Since taxes are an element of the price of gambling they will affect the demand for, or the supply of, particular types of gambling. (The extent to which taxes are actually paid by the punter rather than the supplier - the "incidence" of the tax - will depend on demand and supply conditions.) It may be possible therefore to use the tax system to discourage certain types of gambling, just as taxes can be used to discourage smoking. Alternatively it may be possible to use the tax system to raise revenue from activities which impose costs on society in order to reimburse those costs to the general taxpayer. It is not clear which, if either, of those two motives explains the current structure of gambling taxation. It is possible that it reflects the more familiar motive of raising revenue where it is easy to do so.



Duty	Type of Duty	Current Rate of Duty
National Lottery	% of amount staked	12%
General Betting*	% of amount staked	6.75%
Bingo	% of weekly stake and added prize money	10% of the price of the bingo card plus 1/9th of added prize money
Pool Betting	% of amount staked	17.50%
Gaming Duty**	A premises based tax on banded profits	2.5% of first £462K 12.5% of next £1,027,500 20% of next £1,027,500 30% of next £1,798,500 40% of remainder
Amusement Machine Licence	Licence for each machine or for premises based on machines in use	Licence value £250, £645 or £,1815 pa dependent on machine type and cost per play

*In March 2001, Customs & Excise announced their intention to replace the transaction based tax with a 15 per cent tax on bookmakers' gross profits (3% on financial spread bets and 10% for all other spread betting). Change anticipated from Jan 2002.

**Rate up to 31 March 2001

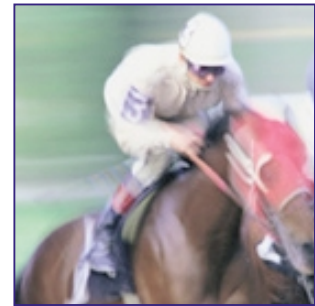
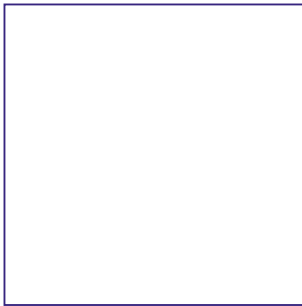
Source: Customs & Excise and NAO (2000)

Figure 36i: Duty rates

- 36.6 We do not interpret our terms of reference as requiring us to comment on the social effects, whatever they may be, of the current system of taxation, although if it could be done, we would support a system which identified and taxed more heavily forms of gambling which were most likely to cause problem gambling. We note that pool betting and the National Lottery (which are normally thought of as soft forms of gambling) are among the most heavily taxed. However there is a high and progressive system of taxation on gaming.
- 36.7 Even if there were agreement that social objectives should affect the design of the system of taxation it is not clear, as we discuss below, whether this is practical in the face of technical change. There is also the question of whether a tax or levy system should be used as a means of supporting the related activity – as is the case with the Horserace Levy. In chapter 13 we said that we did not believe that the question of whether betting should support the underlying sport was a matter for the regulation of gambling.
- 36.8 The tax system can also affect the choice of location for at least some punters (for example those who might fly to one resort or another). We do not believe that tax rates are a major factor in this choice.

General Betting Duty

- 36.9 While our review was in progress, Customs and Excise conducted a consultation exercise in relation to general betting duty. It was set up in response to the move to offshore sites of certain bookmakers who levied a deduction of 3% on telephone bets and nil deductions on internet bets, compared with the 9 per cent (for general betting duty and the Horserace Levy) deducted on UK-based off-course bets. Thus the issue was not one of the choice between one form of gambling and another but of choice between one supplier and another.
- 36.10 Customs and Excise said that the challenge was to create a robust tax regime that ensured:
- a fair challenge for UK bookmakers to compete internationally
 - a fair opportunity for horse racing to secure financial support
 - a fair contribution from the industry towards general tax revenues.



- 36.11** After the consultation exercise the changes to the taxation of betting announced in the 2001 Budget were presented as:

a radical reform of betting duty which will create the right competitive environment for British-based bookmakers to develop their business domestically and internationally, and give punters a better deal.¹

- 36.12** A new system of tax on bookmakers' gross profits (at 15%) will replace the current General Betting Duty of 6.75% on total stakes. Under the current system, off-course bookmakers charge a 'deduction' of 9% of the stake to cover general betting duty and the levy. (In fact the 9% is normally added as a charge to the stake so that a customer pays £10.90 for a £10 stake.) Since General Betting Duty only applies to bookmakers located in the UK, off-shore operators could offer better odds and attract punters.

- 36.13** We have said that the punter will usually be unaware of the tax rate he is facing. Taxation can be part of the wedge between the punters' stakes and the amount paid out as winnings. The other parts of the wedge consist of the operators' costs and profits. The punter may be aware of the average size of this wedge for a particular activity, but he will usually be unaware of, or uninterested in, its composition. General betting duty is unusual in that it was an identifiable charge or deduction (although it was combined with the levy). Thus the punter knew that for every £1.09 he paid at the betting shop only £1 was being staked on the horse he fancied. If the same odds were available without the deduction he would prefer to avoid it. Offshore betting appeared to provide this opportunity and local bookmakers were forced to "absorb" the duty to retain business which involved a squeeze on their profits and also tempted them to move offshore. As a deliberate encouragement to race going, on course bookmakers did not pay the duty. The duty could also be avoided through illegal betting.

- 36.14** The Government also made the following comments:

The reformed tax structure makes it possible to absorb the tax and to end the 9 per cent 'deduction' they currently charge on stakes which mean punters will pay no tax.

This reform will remove any incentive for illicit gambling and should help eradicate the illegal untaxed market in betting, which is currently estimated to be worth approximately £500 million a year.²

- 36.15** Both statements may be slightly optimistic. It is true that punters will not pay General Betting Duty in the way they do now; but if they do not pay the new tax,

who will? If it is simply absorbed by the bookmakers they will find their profits reduced. One might expect some adjustment off the odds so that the gross profit (the difference between the stakes and the winnings) rises. The punter is likely to pay one way or another. The outcome will depend on the competitiveness of the industry. Under the starting price system it will continue to be true that the odds for most off-course punters will be set at the racecourse, where the bookmakers do not pay any form of betting tax (though they are subject to corporation tax). But they are all part of one market.

- 36.16** The illegal market will certainly lose its relative attractiveness if it offers bets at starting prices, since the same odds will be available at betting shops and there will be no general betting duty deduction. However it will be able to offer more favourable ante-post odds if it is able to avoid the tax on gross profits.

Tax and on-line gambling

- 36.17** General Betting Duty represents a good example of the type of problem generated by the internet or any other form of on-line gambling. Internet and telephone betting are close substitutes for placing bets in a betting shop, as is interactive TV betting. Apart from the possible question of the honesty of the supplier, the punter is indifferent as to whether the on-line bookmaker is located in the UK or elsewhere. Hence the vulnerability of the tax take. The Government's solution was to change the basis of the tax and to reduce its effective rate. When the new system is introduced there will be single tax system for all UK-based off-course betting. As now, on-course betting will have a competitive advantage. It will not be possible, in practical terms, to prevent overseas companies from supplying a "tax-free" betting service. However, as we propose in chapter 30, such a company will not be able to register with the Gambling Commission. The site will not have a kitemark and punters will use it at their own risk. It will not be an easy matter to fix the tax at the right level. If it is set too high, more punters will take the risk and deal with a non-registered supplier. As long as we continue (as we firmly believe we should) the present system under which the punter does not commit an offence by gambling on an unregistered site there is nothing to stop him moving.

- 36.18** At the moment, gaming sites cannot legally be provided on-line by UK-based companies. Under our proposals, companies will be able to register with the Gambling Commission to do so. We assume that registration will be limited to those companies based in the UK who can therefore be required to pay tax on the gambling transactions, as under the present



system. That will not prevent foreign companies from establishing subsidiaries based in the UK. The UK companies will therefore compete on level terms with overseas companies that are prepared to meet the requirements for registration with the Gambling Commission. As with betting it will not be possible to stop overseas companies that wish to avoid paying tax setting up on-line sites to which UK residents have access; but the punter will be running a risk. As with betting, if the tax is set too high, more will be tempted to move to unregistered sites. It is possible that the UK will find itself forced to reduce tax rates. That is an illustration of the general principle that it is difficult to tax highly mobile factors of production.

- 36.19** We find it hard to predict whether Customs and Excise will find an easy way to tax “virtual” machines in the way that it tackles physical ones. It may also find it difficult to retain the distinction between the taxation of bingo and the taxation of gaming that prevails under the present system when both are virtual, though the problem does not seem insoluble.

Regulation and international competition

- 36.20** Just as activities can shift in response to differences in taxation, so can they also shift in response to differences in regulation. Indeed the success of the City of London has often been attributed to its relatively light regulation. There are two types of risk. The first is that travellers may avoid gambling in locations where they find the regulation too oppressive. The second is that interactive services may be provided from locations where regulation is lighter. We believe that an incidental effect of our proposals will be that the physical UK gambling sites, especially casinos, will become more attractive to overseas visitors and to British residents who might otherwise travel abroad to gamble. The second, as with taxation, is a question of balance. Under our proposals it will be a virtue of on-line gambling sites registered with the Gambling Commission that they will meet very high standards of probity and knowledge. If these standards are excessive, suppliers and punters will migrate to unregistered sites. We believe that our proposals reach the right balance.