The Gambling Bill and Remote Gambling

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EXECUTIVE SUMMARY

1 The Gambling Bill currently before Parliament aims to modernise British gambling laws. The Bill deserves close attention given it will significantly affect consumers, the gambling industry and government finances. The Association of Remote Gambling Operators (ARGO) commissioned Europe Economics to conduct a preliminary assessment of how attractive Britain will be as a location for remote-gambling operators after the Bill has passed.

2 The Department for Culture Media and Sports (DCMS) has identified a number of benefits for the remote-gambling sector that the Gambling Bill might realise, including greater employment opportunities, higher tax revenue generation, better regulation, and better choice, information and safeguards for customers. The perceived benefits assume that the regulatory environment after the Gambling Bill will be such that the volume of remote gambling using sites regulated in Britain will increase.

3 Yet this may not happen given the likely tax environment and effect of the proposals in the Bill. The competitive nature of the global remote gambling market means that Britain's attractiveness as a venue in which to be licensed cannot be taken for granted. There are a number of other jurisdictions with favourable tax and regulatory regimes seeking to attract remote-gambling operators.

4 This study analyses the options available to remote-gambling operators assuming the Gambling Bill passes in its current form. A model is developed to compare the options and help determine which outcomes seem most likely under various assumptions. The findings are compared to what the model might predict should the status quo remain.

5 The conclusions are stark. The government's hopes of Britain being the centre for this industry will not be realised. The tax liabilities that British-based operators would face are likely to be too high. Only online betting operators that serve almost exclusively British customers are likely to locate their operations in Britain. Even this finding requires assuming significant difficulties in attracting British customers for operators based outside Britain after the Gambling Bill (*e.g.* assuming that a ban on advertising by unlicensed operators can be enforced effectively).

6 The opportunity to regulate remote-gambling operators might be lost if regulations and taxes are set with no regard to the commercial realities facing operators. Of most concern is the possibility that British regulatory oversight of the industry will fall as most operators choose to seek licences elsewhere. It would be an unfortunate consequence if the Gambling Bill, introduced to modernise British gambling laws and the related tax regime, were to deter remote-gambling operators from seeking British licences and placing those that do at a competitive disadvantage. To avoid this outcome the government needs to adopt regulations that are effective, proportionate and targeted; and recognise that taxes influence the location decision of operators and therefore the effectiveness of any regulations.

1 INTRODUCTION

> Licensing and regulating online gambling will present a number of challenges that do not necessarily arise through more traditional forms of gambling media.
>
> Paragraph 4.50, DCMS (2002) *A Safe Bet for Success,* www.culture.gov.uk

1.1 The Association for Remote Gambling Operators commissioned Europe Economics to prepare this report looking at the effect the Gambling Bill might have on remote-gambling operations, given the current tax regime in Britain and some of the measures that are being mooted concerning regulation.

1.2 The Gambling Bill is currently going through Parliament. The government has identified three main objectives for gambling regulation that it wants the Bill to realise:

(a) to prevent gambling being a source of crime and disorder;

(b) to ensure that gambling is conducted in a fair and open way; and

(c) to protect children and other vulnerable persons from being harmed or exploited by gambling.[1]

1.3 The Bill has been lauded by many in the gambling industry as a welcome opportunity to modernise Britain's gambling laws. The existing legislation predates a number of important developments. This is particularly so for remote gambling, a possibility that was not anticipated at the time most of the current laws were drafted. Remote gambling has some unique aspects, which means that it might not always be appropriate to apply regulatory practices suitable for "traditional" forms of gambling to the remote-gambling sector.

1.4 Although the details of the regulation have not yet been determined, the DCMS has already identified a number of benefits for the remote-gambling sector that the Gambling Bill might realise:

(a) Greater employment opportunities;

(b) Higher (tax) revenue generation;

(c) Better regulation; and

(d) Better choice, information and safeguards for customers.[2]

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[1] Paragraph 1.5, DCMS (2004) *Gambling Bill Regulatory Impact Assessment* www.culture.gov.uk
[2] Paragraph 6.17, DCMS (2004) *Gambling Bill Regulatory Impact Assessment* www.culture.gov.uk

1.5 In identifying these benefits, the DCMS has considered the alternative option of retaining the status quo, where British customers can participate in all forms of remote gambling but operators can only offer remote betting (if they have a British betting licence) and not remote gaming from a base in Britain.

1.6 The perceived benefits assume that the regulatory environment after the Gambling Bill will be such that the number of remote-gambling sites located in Britain will increase. This will create the additional employment opportunities in both the remote-gambling industry and related industries (such as software development). It is also the assumption underlying the belief that Britain will capture a greater share of the international remote gambling market and, more importantly from the government's perspective, the associated tax revenues and duties that might be available. Clearly, the last two benefits identified can only be realised if operators locate in Britain. Otherwise the Gambling Commission will not be able to licence operators and check that they are crime free and comply with British laws, nor ensure adherence to any strict rules it deems necessary to prevent underage gambling and to reduce the risk of problem gambling.

1.7 This suggests that the government should add *effectiveness* to the other principles of good regulation — transparency, accountability, proportionality, consistency and targeting — that the DCMS has identified.[3] Any regulations that the Gambling Commission implements will not be effective if they deter operators from seeking a British licence.

1.8 This paper considers how one particular regulatory measure—requiring British-licensed operators to locate their operations in Britain—satisfies these principles. It focuses particularly on just how effective such a measure might be. Will it realise the benefits of modernising the law to reflect technological developments better?

1.9 Effectiveness is one of the traditional criteria used to assess taxation proposals. Previous government documents have outlined how the principle should be applied to the taxation of e-commerce: the tax rules should not result in either double taxation or unintentional non-taxation, and risks from increased evasion and avoidance should be kept to a minimum.[4] It makes sense that any regulation of e-commerce should similarly seek to reduce the risk of increased evasion and avoidance of such regulations.

1.10 As this paper illustrates, realising the link between taxation and regulation of remote gambling is particularly important. The more unfavourable the tax regime vis-à-vis other jurisdictions, the harder it will be for the British government to regulate online gambling operators (since any measures that impose a regulatory or taxation cost on the operator are more likely to persuade the operator to locate elsewhere). Thinking through tax policies or regulatory policies in isolation runs the risk of a second-best outcome.

[3] Paragraph 3.2, DCMS (2002) *A Safe Bet for Success* www.culture.gov.uk

[4] These principles were first set out in an Inland Revenue press release dated 6 October 1998. They have been reiterated in subsequent policy documents, including Inland Revenue and HM Customs & Excise (1999) *Electronic Commerce: the UK's Taxation Agenda,* www.inlandrevenue.gov.uk and Cabinet Office (1999) *e-commerce@its.best.uk,* www.cabinet-office.gov.uk.

1.11 The next chapter summarises the environment in which ARGO's members operate. It first outlines how the Gambling Bill will potentially affect remote-gaming operators. It then describes the global market for remote gambling, arguing that the sector is large but also fiercely competitive. This competitiveness makes it imperative that operators locate in favourable locations; the size of the market has resulted in a number of jurisdictions seeking to attract operators. The chapter ends by providing a brief overview of the regulatory and tax regimes of some of the more popular jurisdictions for remote-gambling operators.

1.12 The report then seeks to demonstrate the attractiveness or otherwise of being licensed in Britain. This is done by constructing a model to calculate a representative operator's profits. The model makes a number of assumptions about factors such as taxes, costs of relocating, demand, etc. The implications of changing these assumptions are also discussed. The finding that emerges is that it is very difficult to generate a scenario where remote-gambling operators would choose to locate all their operations in Britain given the potential tax regime, even assuming the cost of regulation itself was to be neutral.

1.13 The final chapter concludes, observing how well regulatory plans to require all of a gambling operators' operations to be in Britain fare against the criteria of effectiveness, transparency, accountability, proportionality, consistency and targeting.

2 GLOBAL COMPETITIVE PRESSURES

Future Regulation of Remote Gambling in Britain

2.1 The government has taken several steps to modernise British gambling laws, partly motivated by the increased importance of the activity: almost three quarters of British adults participate in some form of gambling.[5] Moreover, as the sector opens up to global competition (largely due to the technological developments that facilitate remote gambling) the government is keen to have in place laws that facilitate "a successful British gambling industry".[6]

2.2 The laws currently governing remote gambling in Britain came into force in the pre-internet era. The three statutes of most relevance are the 1963 Betting, Gaming and Lottery Act, the 1968 Gaming Act and the 1976 Lotteries and Amusements Act. Currently remote betting and lotteries can be provided in Britain, but it is illegal to provide remote-gaming services. To offer remote-betting services, an operator needs to hold a bookmaker permit granted by a local licensing magistrate, while an online lottery operator in Britain needs to register with the appropriate local authority or the Gaming Board.

2.3 One of the major recommendations of the 2001 Budd Report was that online gaming should be permitted in Britain.[7] The government subsequently published a White Paper in 2002 setting out the government's plans for modernising legislations governing gambling.[8] The Gambling Bill currently before parliament was published 19 October 2004. If passed, it will replace all existing laws for gambling in Great Britain, and it will lead to the establishment of a new independent regulator, the Gambling Commission.

2.4 It will be for the Gambling Commission to license and regulate the main forms of commercial gambling, including remote gaming which operators will for the first time be permitted to offer from within Britain. Although the DCMS has published a position paper outlining how a British-based online gambling industry might be regulated,[9] the current Bill would allow the Gambling Commission considerable discretion. The government has recognised going forward that future technological developments mean that remote-gambling regulations need to be flexible and responsive. It consequently intends to leave it for the Gambling Commission to determine detailed regulatory measures and procedures, rather than specifying them in the Gambling Bill.

2.5 Nevertheless, some clauses of the Bill are of direct relevance to remote-gambling operators. Clause 35 of the Bill requires operators to have a remote-gambling licence if any of their gambling equipment (including customer registration, back office and gaming

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[5] Paragraph 1.3, DCMS (2002) "A safe bet for success" www.culture.gov.uk
[6] Foreword to DCMS (2002) "A safe bet for success" www.culture.gov.uk
[7] Paragraphs 30.20 and 30.43, DCMS (2001) "Gambling Review Report" www.culture.gov.uk
[8] DCMS (2002) "A safe bet for success" www.culture.gov.uk
[9] DCMS (2003) "The future regulation of remote gambling: a HCMS position paper" www.culture.gov.uk

servers, money deposit and funds out processes etc) is located in Britain, although planned government amendments would relax the requirement.[10] Most remote-betting operators targeting the British market carry out at least some of those processes within Britain and would thus require British licensing. Moreover, their gaming operations, albeit licensed offshore, are intrinsically linked to their betting operations and would also require licensing under the Bill.

2.6 Clause 87(2) requires that operators licensed in Britain locate all of their gambling equipment in Britain. Operators will have to operate wholly from within Britain or to locate all of their operations, systems and processes overseas. Europe Economics has been advised that remote-gambling operators appreciate the government's willingness to compromise to ensure that this measure is not unnecessarily onerous.

2.7 Further, clauses 325 and 327 prohibit offshore remote gambling operators from advertising or promoting their services in the British media. The Bill makes an exception for operators licensed in EEA countries, and some not yet specified qualified jurisdictions whose regulatory and customer protection regimes are approved as rigorous in the future.

2.8 Put together, these clauses may have some unintended implications for the strategies of remote-gambling operators, potentially mitigating the benefits the Bill is expected to produce for British consumers, the remote-gambling sector, the government and society as a whole. These are further analysed in the next chapter. Before that, the paper describes the global market for remote gambling and some of the alternative jurisdictions where operators might locate.

The Global Market for Remote Betting and Gaming

2.9 Remote gambling can be done on various platforms, including the internet, interactive television, and telephones. Remote gambling takes many forms, including casinos, lotteries and sports/events betting. In 2002, 55 per cent of online gambling market revenue came from online casinos, 43 per cent came from online sports/events betting, and the remaining 2 per cent came from lotteries.[11]

2.10 The remote-gambling industry is still considered to be in its infancy, yet already it generates significant annual revenues (and profits) for existing operators. It is estimated that there are currently around 1,700 online gambling sites, and 15 million online gamblers are expected to generate a turnover of $30 billion in 2005.[12] This would be double the turnover of just four years earlier; in 2001 global remote gambling turnover was $15 billion.[13]

10 All clause numbers refer to *The Gambling Bill 2005* HL Bill (2004–2005) 19
11 www.microgaming.com
12 DCMS (2003) "The future regulation of remote gambling: a DCMS position paper" www.culture.gov.uk
13 www.microgaming.com

2.11 One particular success story has been on-line poker, which has become more important to operators' commercial success. Perceived as a game of more skill than other, machine-based forms of remote gaming, it has enjoyed a vast increase in popularity with people across all age and social groups. Already 29 per cent of the British public has played it, and 10 per cent of those who have never played would like to play in a poker tournament.[14]

2.12 The country with the largest market for online gambling today is the US, with more than 4 million online gamblers and $7.6 billion online gambling revenue expected in 2005.[15] The Asia-Pacific region might be a more important market. It accounted for 57 per cent of gamblers and 59 per cent of online gambling revenues in 2002. One source estimates that in 2005 there will be 7.7 million Asia-Pacific online gamblers.[16]

2.13 Although the European online gambling market has fewer customers and generates less revenue than the US or the Asia-Pacific markets, it has become an increasingly attractive market for remote-gaming operators. This is because of the significant potential for growth and the more favourable regulatory environment towards online gambling. It is expected that in 2005 there will be 3.3 million online gamblers in Europe, over a quarter of them (0.9 million) in the UK.[17]

2.14 The size of the remote-gambling market has attracted a large number of operators. Competition to attract customers and keep them is fierce. The margins enjoyed in remote gaming are small, with the payout percentage often around 98 per cent. It is not unusual for operators to offer games where the payout percentage exceeds 100 per cent.

2.15 Nor is competition confined to the payout ratios. Operators frequently have promotions that give bonuses to customers when they deposit funds on a site. Two years ago, one source suggested that the promotional costs to attract and retain a US customer were $250.[18]

2.16 The high turnover of customers which operators have reported to Europe Economics highlights the constant need for remote-gaming operators to compete aggressively for customers.

Competitiveness of the Global Market

2.17 The competitiveness of the remote-gambling market is perhaps to be expected. In the absence of regulation, the barriers to entry (and exit) are small. It is relatively straightforward to set up a remote-gambling operation.

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[14] http://www.ladbrokespoker.com/features/popups/PokerReport2.pdf
[15] www.microgaming.com
[16] International Gaming and Wagering Business (2002) "Internet gaming: an industry survey" www.microgaming.com.
[17] International Gaming and Wagering Business (2003) "New trends in online gaming" www.micorgaming.com
[18] International Gaming and Wagering Business (2003) "New trends in online gaming" www.micorgaming.com

2.18 Many of the components required to provide remote-gambling services—gambling server and software, distribution, payment system, customer support services, and back-office operations—can easily be sourced from other providers, should the operator prefer.

2.19 For example, specialists such as NETeller make it easy for online operators to arrange a payment system so that they can receive deposits and pay winnings to customers remotely.

2.20 A remote-gambling operation needs a server and suitable software to provide the gambling functionality. For remote gaming, it is the generation of (random) numbers that constitutes the events on which people wager. Consequently, the key part of gaming software is the random number generator (RNG). Although specific software code will be required for each gambling service, e.g. online poker or blackjack, the different games do not present especially large IT challenges.

2.21 Although many sites use proprietary software, there are a number of providers available for businesses that decide not to develop the software in-house. The gambling software providers typically offer a full range of software products, including software for sports betting, casino, poker, lottery, bingo, fixed-odds games, and probability games, as well as back-office operations. The gambling software providers also offer one-stop-shop services ranging from system design and implementation, to daily operation maintenance and support.

2.22 Leading online gambling software businesses include Access Gaming Systems, Betware, Boss Media, Chartwell Technology, CryptoLogic, Microgaming Systems, Playtech, Real Time Gaming, WagerWorks and World Gaming.[19] Market shares are hard to establish since available data are limited because many of these entities are private companies; moreover there is not always agreement about which companies are competing in the same market. Of about 25 major contracts announced in 2003, Boss Media claimed to have accounted for almost 40 per cent.[20] A different source using 2002 data estimated that Micrograming had a 38 per cent share of the market, while CryptoLogic and Boss Media had market shares of 21 and 11 per cent respectively.[21]

2.23 These businesses' revenues come from a combination of licence fees and royalties. For example, Microgaming charges an up-front reservation fee and then a monthly usage fee of between 15 and 25 per cent of gross win, depending on the online casino's revenues.[22]

2.24 The evidence suggests that royalties are the main source of income for gambling software providers. In 2004 58 per cent of Boss Media's revenue came from royalties, 34 per cent came from licence sales, 8 per cent came from services and support, and 1 per

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[19] Page 12, Boss Media (2004) "Annual Report 2003" investors.bossmedia.se/files/bossmedia_annualreport2003_en.pdf
[20] Page 12, Boss Media (2004) "Annual Report 2003" investors.bossmedia.se/files/bossmedia_annualreport2003_en.pdf
[21] Page 12, Datamonitor (2002) "Focus on Microgaming" www. datamonitor.com
[22] Page 11, Datamonitor (2002) "Focus on Microgaming" www. datamonitor.com

cent came from other sources.[23] Entrants appear to have the option of avoiding large up-front investments acquiring software; they do not need to expose themselves to large financial risks should the venture prove unsuccessful. Instead, operators can agree to pay royalties, a variable cost related to turnover rather than a sunk cost incurred regardless of how the business subsequently fares.

2.25 Back-office operations include reporting and administrating system, back-up system, disaster recovery system, etc. Reporting systems can compile for operators useful information and statistics, such as account histories, customer preferences and playing patterns, to aid marketing and promotion campaigns.

Choice of location

2.26 The competitiveness of the remote-gambling market increases the importance of decisions such as where to locate the business. Any marginal advantage an operator can gain by choosing a better environment to locate the business will be especially important. For example, jurisdictions with favourable tax regimes will be attractive.

2.27 GamblingLicenses identifies four key factors that influence where remote-gambling operators decide to locate.[24]

(a) *Jurisdictional commerciality.* What is the availability of licences for the various forms of remote gambling, such as betting, casinos, betting exchanges and lotteries?

(b) *Regulatory structure.* It is not just the regulations themselves that are important (reputable operators will often favour light-touch regulation to no regulation). The tax rates and the cost of licences (including the costs of satisfying licence terms) will clearly have a big impact. And although seemingly trivial, some jurisdictions are more attractive than others simply because ascertaining information and dealing with regulatory bodies is easier and quicker.

(c) *Policy stability*. How likely and what form will changes to policies governing interactive gaming take given the political environment (government stability, GDP, general taxation)?

(d) *Telecommunications facilities*. Operators will care about the availability, reliability and the cost of internet access, leased lines, satellite communications, etc.

2.28 Britain has fared well when benchmarked against these criteria, notwithstanding the failure to offer licences for online gaming operators. Its advantages include an excellent infrastructure, a stable policy environment and a generally favourable regulatory structure.

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23 Boss Media "Year-end report 2004" investors.bossmedia.se/files/bossmedia_Q42004_en2.pdf

24 www.gamblinglicenses.com

Many remote-betting operators are located in Britain. The total estimated traffic volume for British-based sites is second only to the traffic volume for sites based in Gibraltar.[25]

2.29 But care should be taken in assuming that Britain's popularity as a venue for remote-betting operations will automatically transfer over to other forms of remote gambling. The big bookmakers—Ladbrokes, William Hill and Coral—have significant land-based operations and their decisions to locate their remote-betting business in Britain have arguably been influenced in part by a desire to ensure a favourable environment for their general betting business. Such considerations will be less significant when remote-gaming operators choose whether to locate in Britain.

2.30 There are other jurisdictions that are attractive to remote-gambling operators, and the options for operators deciding where to locate are likely to increase in the coming years. Many jurisdictions share Britain's goal of becoming a centre for this industry, having identified the potential growth of the remote-gambling industry, and are starting to adapt their regulatory environments accordingly. This includes jurisdictions within the EU, such as Malta (discussed below) and Cyprus.

2.31 Britain's attractiveness as a venue for remote gambling cannot be taken for granted. Heavy-handed regulation and high tax liabilities in Britain are likely to persuade operators seeking a global presence to locate elsewhere, perhaps sacrificing some market share in Britain so as to remain competitive elsewhere. Even if policymakers were not interested in attracting global operators, they need to consider the likelihood of operators who target British customers choosing to seek a British licence. At the very least, the British regulatory environment will have to be competitive with what is available in other EEA jurisdictions.

Alternative Locations for Remote-Gambling Operators

2.32 This subsection discusses the current regulatory environment in some of the jurisdictions that are currently most attractive to remote-gambling operators. GamblingLicenses gives all of the ones selected a top overall rating of four stars, the same as the UK, as a venue for remote-gambling operators to seek a licence. Some of these jurisdictions are inside the EEA.

Malta

2.33 Malta's recent admission to the European Union means that it may be a particularly attractive venue for remote-gambling operators looking for a location from which to serve the British market, especially if regulations governing advertising distinguish between sites based in the EEA and sites based elsewhere. The country already has the infrastructure

[25] online.casinocity.com

and regulations in place to support remote-gambling operations. The fact that the OECD does not classify Malta as a tax haven may also be an advantage.

2.34 The Malta Lotteries and Gaming Authority (LGA) is responsible for licensing firms in the gambling industry. Remote-gambling operators can seek onshore status in Malta, combined with international trading company (ITC) status. ITCs must not conduct trade with Malta's residents (a very small part of the global market) and some of their shares must be owned by non-Maltese legal persons.

2.35 There are four classes of licences of potential interest to remote-gambling operators:

(a) Class 1 — online gaming;

(b) Class 2 — online betting office or online betting exchange;

(c) Class 3 — to promote and abet gaming from Malta;

(d) Class 4 — host and manage third party online gaming operators.[26]

2.36 Licences cost Lm3,000 per annum (about £4,800).[27] In addition, the initial application for a licence is subject to a non-refundable application fee of Lm1,000 (about £1,600), and renewing the licence costs Lm500 (about £800).

2.37 The total gambling duties payable by a licensed operator (not individual licence) are capped at Lm200,000 per year (about £320,000). The gambling taxes are:

(a) At a fixed rate of Lm2,000 per month (nil tax for a class 4 licence) for the first six months and subsequently Lm3,000 per month (Lm2,000 for a class 4 licence); plus

(b) 0.5 per cent on the gross amount of bets placed (or in case of betting exchanges 0.5 per cent on the sum of all net winnings calculated per player per betting market; or in the case of pool betting 0.5 per cent);

2.38 The effective corporation tax for an ITC in Malta is 4.17 per cent. The tax on chargeable income is 35 per cent, but non-resident shareholders receiving dividends can claim refunds amounting to 30.83 per cent of the 35 per cent tax paid by the company. There are no withholding taxes, stamp duties or exchange-control restrictions applied to the distribution of profits or dividends to shareholders and there are no taxes or restrictions on the export of dividends from the ITC.[28]

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26 www.gamblinglicenses.com/LicensesDatabaseDetail.cfm?Licenses ID=40&Region=Europe
27 All exchange rates used in this paper were taken from www.xe.com on 5 January 2005.
28 www.ateonline.co.uk

Isle of Man

2.39 The Isle of Man is another location that may be particularly attractive to operators should the British regulatory and tax environment become less favourable. It operates a low income tax system, has an advanced and reliable infrastructure and offers other benefits to operators.

2.40 The jurisdiction seeks to ensure that its “legislation facilitates and fosters the growth of e-business applications”. This is reflected in its approach to legislation governing remote-gambling operators licensed on the island, an approach that has been refined after its initial efforts to attract the industry to the Isle of Man failed.

2.41 The island already has an advanced regulatory framework for remote betting and gaming operations from its previous attempt to attract large US land-based casinos to set up remote-gambling operations in the Isle of Man. These US operators have subsequently closed their remote-gambling operations and left the Isle of Man, concluding that the US laws on remote gambling are unlikely to be relaxed in the near future. But the experience has left the Isle of Man well placed to attract other operators. Also, the Isle of Man has announced that remote-gaming operators will be allowed to accept bets from the US, a move that should make the Isle of Man even more attractive for operators wishing to target the world’s largest gambling market.

2.42 Various incentive schemes for locating business in the Isle of Man exist. These include financial grants of up to 40 per cent of capital spent on equipment, marketing, and relocation costs and professional fee. The grants can go up to 50 per cent for training, and can be applied for on annual basis.[29]

2.43 The island’s new strategy for attracting e-gaming business combines the established regulatory arrangements with lowered licence fees—annual licences fees are £35,000, with an application fee of £1,000. The regulatory requirements relate to true randomness of numbers generated and the collecting and holding of a considerable amount of information. Players must be registered if they are to play games where they might win or lose money. The Commissioners have to approve any changes in the operating system that might affect compliance with the operator’s licence conditions.[30]

2.44 To allow advertising in British media, the Isle of Man levies a 15 per cent duty on betting yield from inside Britain. Betting yield from outside Britain is subject to a 1.5 per cent duty, while a duty of 2.5 per cent is levied on “gross gaming yield”. Online gambling in the Isle of Man is not subject to VAT.[31]

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29 www.incparadise.com/offshore/isle2.htm
30 www.gov.im/gambling/regs/regs2.pdf
31 www.gov.im/gambling/guidance/VAT.pdf

2.45 At the moment the corporation tax for resident companies is 10 per cent for the first £100 million of profit and 15 per cent thereafter. There will be no corporation tax payable after 2006 although in practice remote-gambling operators can already avoid paying corporate taxes. They can apply for exempt status from corporation tax, provided that no Isle of Man resident has an ownership interest in the company and the company does not trade with Isle of Man residents (an even smaller share of the potential global gambling market than Malta). There are also tax allowances for capital expenditure and dividends to shareholders are tax deductible.[32]

Alderney

2.46 The decision of Rank Interactive to move its operation to Alderney in 2003 from the Isle of Man provides evidence that remote-gambling operators do move to jurisdictions offering a more favourable business environment. It also provided final evidence that the Isle of Man's initial online-gambling strategy had failed.

2.47 Alderney remains an attractive venue for remote-gambling operators. It has plans to eliminate corporation tax by or before 2008 (the top band is currently 20 per cent). Other tax advantages include no VAT or gaming taxes, and the personal income tax regime is low (the top rate is 20 per cent).[33]

2.48 The regulatory regime for gambling is regarded favourably by most observers: rigorous but light-handed. When applying for a licence, the application deposit required is £15,000; this is refundable to the extent that the application processing cost less, but it is also possible that applicants will have to provide further deposits if the processing is more expensive.[34]

2.49 The annual licence fee, either for interactive gaming or for electronic betting, is £75,000. The fee for the Certificate of Prior Approval is £30,000.

Gibraltar

2.50 With some sources suggesting that Gibraltar-based sites have the highest traffic volumes, this has clearly proven to be an attractive site for some remote-gambling operators. Many British bookmakers located their remote-betting activities in Gibraltar prior to the British government's switch from a turnover tax to a gross profits tax.

2.51 Gibraltar is keen to develop as a premier location for the establishment of e-commerce business. Various attractions that Gibraltar's authorities cite include: a multi-lingual labour force; well developed telecommunications; and an excellent legal framework based on

32 www.gov.im/treasury/
33 www.alderney.gov.gg
34 www.gamblingcontrol.org/docs/51.pdf

English common law (with specific legislation to facilitate e-commerce planned in the near future).[35]

2.52 All gaming operations in Gibraltar require licensing under the Gaming Ordinance. The Office of the Financial and Development Secretary issues gaming licences, including for telephone and internet betting. The licence application fee is £2,000.[36]

2.53 The gaming tax is currently levied at 1 per cent of turnover for sports betting and 1 per cent of gaming yield (the drop) for internet casinos, with total tax payable capped at £287,000 per annum per licence. In the first two years of a licence, there is a minimum tax contribution — £28,700 and £57,400 in the first and second years for betting and £50,000 in both years for internet gaming operators. Gibraltar does not apply any sales tax or VAT.[37]

2.54 Any Gibraltar company owned by non-residents and that does no business with residents can apply for exempt status or qualifying status. Companies that successfully apply for exempt status are exempt from any tax on income or withholding tax on dividends and interest. Instead, they must pay an annual fee to maintain exempt status of £225 (£200 for companies not ordinarily resident in Gibraltar for tax purposes and for branches of overseas companies). An exempt company may have local offices, employ local staff, use local banks and have its central management in Gibraltar.[38] A company with qualifying status may apply to pay tax at a rate agreed with the government of between 0 per cent and 35 per cent (the standard rate of tax for resident companies).

Jurisdictions outside Europe

2.55 If operators are comfortable being located in jurisdictions from where it will be illegal to advertise into Britain, then there are no technical reasons why they cannot locate outside Europe. (Some locations may have regulatory regimes that the British authorities deem satisfactory, such that it will remain possible to advertise into Britain.) A number of jurisdictions, mainly in the Caribbean, have already become centres for online gambling.

2.56 The importance of online gambling to Antigua is perhaps best illustrated by its decision to bring a case concerning US regulations governing online gambling before the World Trade Organisation. Given the importance of this sector to the Antiguan economy, it is not surprising that the environment is favourable to remote-gambling operators. Foreign corporations can avoid the 40 per cent corporation tax by repatriating profits. They are also eligible for a 15 year tax holiday. Interactive betting and gaming is in theory subject to a 3 per cent tax on the gross handle, although in practice operators do not pay this.

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35 www.gibraltar.gov.gi/index.htm
36 Page 9, Interactive Gam7ing, Gambling and Betting Association (2004) "Remote gambling and UK taxation: an iGGBA position statement", www.iggba.org.uk/html/graphics/remote_gambling_and_uk_taxation.pdf
37 www.gibraltar.gov.gi/gov_depts/internet_gaming/internet_gaming.htm
38 www.gibraltar.gov.gi/index.htm

Licences cost US$75,000 (about £40,000) for interactive gaming and US$50,000 (about £27,000) for interactive wagering.[39] Licence holders are subject to software checks for fairness, and due diligence checks on holding companies and individuals.

2.57 Curacao is another Caribbean jurisdiction that has a sizeable remote gambling sector. Cyberluck Curacao NV, a private company, holds a Master Licensing Authority. This allows it to issue unlimited licences to qualified internet gambling operators. The monthly licence fee is NAf10,000 (about £3,000).[40] Thereafter, operators are subject to a tax on profits capped at 2 per cent and no import duties or turnover tax. Moreover, there is a special income tax regime for expatriates working from the E-zones. A further attraction is that the regulatory compliance costs for operators licensed in Curacao are almost zero

2.58 Outside the Caribbean, the Mohawk Territory of Kahnawake in Canada is a popular jurisdiction. The Kahnawake Gaming Commission regulates and licences all gaming sites operated there under Section 35(1) of Canada's 1982 Constitution Act. Mohawk Internet Technologies, a non-incorporated entity wholly owned and controlled by the Mohawk Council of Kahnawake, provides the e-commerce services necessary to operate gaming sites. Licences cost C$10,000 (about £4,300) per year, with an initial application fee of C$20,000 including a C$5,000 non-refundable deposit.[41]

Summary

2.59 All the jurisdictions discussed above offer regulatory regimes that have advantages over Britain for a remote-gambling operator seeking to compete in the global market. This is particularly true when thinking about the tax regimes. Table 2.1 summarises the gambling taxes and corporate taxes in place, as well as the annual licence fees operators have to pay.

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39 www.antiguagaming.gov.ag/legislation2.asp

40 www.casinoman.net/content/netsafety/casino_license_jurisdictions.asp

41 online.casinocity.com/jurisdictions/jurisdiction.cfm?Id=8

Table 2.1: Summary of gambling licence fees and taxation in alternative locations

Location	Annual Licence Fee (£)*	Gambling tax	Corporate tax
Malta	4,800	0.5% of turnover capped at c. £320,000 per annum	4.17% effective
Isle of Man	35,000	2.5% of gross win (different if customer UK based)	Max 15% but zero from 2006
Alderney	75,000	None	Max 20% but zero by 2008
Gibraltar	2,000	1% of turnover/gaming yield capped at £287,000	Zero if granted exempt status
Antigua	39,800[g] 26,600[b]	3% of gross handle	Zero
Curacao	35,400	None	Max 2%
Kahnawake	4,300	None	Zero

[g] Gaming, [b] betting
**Local currencies have been converted into sterling using the exchange rates quoted by www.xe.com on 5 January 2005.*

2.60 In designing its regulations of the gaming industry and setting taxes, Britain cannot afford to ignore these financial incentives that operators have to locate elsewhere. The above table indicates that a betting tax set higher than 2 or 3 percent of gross win could seriously disadvantage remote-gambling operators based in Britain. The next section illustrates how operators are likely to respond if the UK continues to apply a 15 per cent gross profits tax.

3 POSSIBLE EFFECTS OF THE GAMBLING BILL

3.1 This chapter builds on the preceding chapter, attempting to illustrate the financial implications for remote-gambling operators of different choices about where to locate their business. The work focuses on the implications for operators if, following the Gambling Bill's passage into law, a British remote gaming licence will only be granted if the operator moves its operations into Britain.

3.2 A model is developed using data in the public domain and information provided in confidence to Europe Economics by various member companies of ARGO. The model uses assumptions that appear to accord with the business realities facing operators, although there is no attempt to make the model representative of the situation facing any particular operator. Where a range of plausible assumptions could be made, the model adopts assumptions most favourable to operators locating in Britain. For example, it assumes a 50 per cent fall in British customers for operators based outside the UK.

3.3 The model compares the financial implications of four different decisions on where to locate operations for a remote-gambling operator. The analysis does not attempt to model the dynamic interactions between operators, nor how expectations about the regulatory environment in the future might affect decisions. Instead the analysis uses a comparative static framework and assumes that the operator could affect any changes in the location of parts of their business immediately. The impact on regulatory costs is assumed to be neutral in all cases. The results are presented for six different hypothetical operators, who differ in the relative importance of different sources of remote-gambling revenue.

3.4 First we describe the four possible decisions available to the operators and the six different types of operator considered. This is followed by discussion of the modelling approach, describing the key assumptions made for the analysis and the rationale for making them. Then the results are discussed, including a discussion of how sensitive the results are to various assumptions and other possible refinements that might be made. Some implications of the results are highlighted at the end.

Possibilities for Operators

3.5 The model assumes that currently the remote-gambling operator has a British betting licence and its remote-betting operations in Britain, while its remote-gaming operations are based elsewhere, with some shared facilities between the two. This arrangement will not be sustainable if the regulatory environment, after the Gambling Bill becomes law, requires that remote-gambling operators locate most of their operations in Britain in order to be licensed here.

3.6 In broad terms, there appear to be four alternatives available to remote-gambling operators:

1. Locate all of their remote betting and gaming operations in Britain;

2. Locate all of their remote betting and gaming operations outside Britain;

3. Separate British and non-British operations (subject to licence constraints) with licensed operations in Britain servicing British costumers and non-British licensed operations servicing customers outside Britain;

4. Separate the betting and gaming operations to operate betting licensed in Britain and gaming licensed outside Britain.

3.7 The model compares the financial implications of these four location decisions. It does not attempt to model which jurisdiction operators will choose if they decide not to locate all of their business in Britain. The focus is on just how attractive Britain is compared to an unspecified alternative location. The model does make assumptions about the regulatory environment outside Britain, assumptions that are consistent with the jurisdictions described in the preceding chapter.

3.8 The four options all entail costs involved with re-arranging the business. Option 1 would incur a cost of relocating gaming into Britain and Option 2 would incur the cost of relocating betting operations, as well as the cost of moving any shared operations, such as back office and data processing, which might at the moment be at the same location for both services. Option 3 would incur the cost of duplicating the same operations in different locations. Option 4 would incur relocation costs only to the extent that currently shared operations between the two services have to be separated. Under options 3 and 4 there would also be the costs associated with divesting parts of a business.

3.9 Another important consideration will be the effect on revenues. Operators located outside Britain may be at a disadvantage, especially those located outside the EEA if they are banned from advertising in Britain as currently envisaged in the Gambling Bill (assuming the ban can be enforced). Option 4 may also have adverse implications for demand, since the operator would forego the possibility of cross-service promotion and registration. Instead, customers would have to hold two separate accounts.

3.10 For remote-gambling operators, the division of their customer base between Britain and elsewhere is likely to be one of the decisive factors in location decisions. Two stark possibilities are modelled: an operator that serves only British customers and an operator that serves a global customer base (including British customers).

3.11 Another important consideration will be the relative importance of gaming and betting to the remote-gambling operator's business success. Again, the modelling only looks at a limited number (three) of possibilities: operators whose source of turnover is solely betting; solely gaming; or split equally between the two.

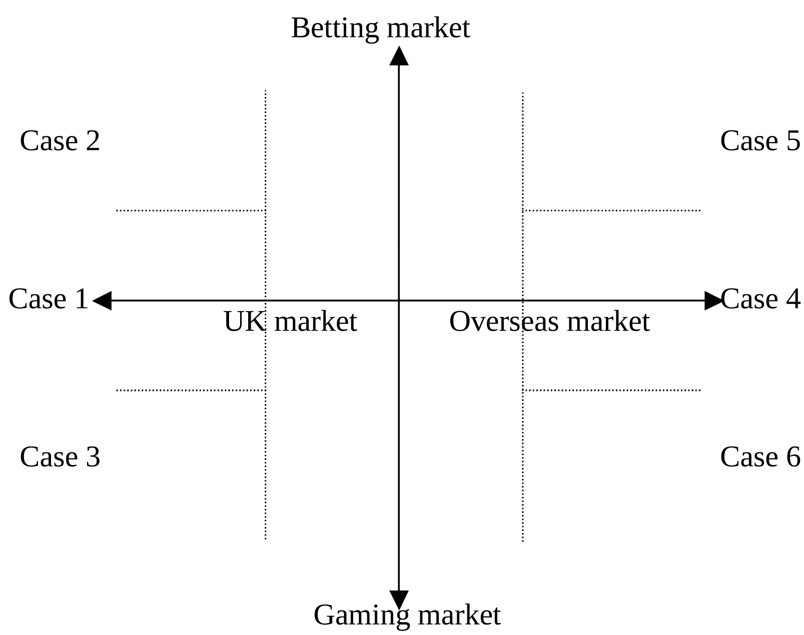
3.12 Combining the two possible customer location profiles with the three possible splits between gaming and betting turnovers means that in total six hypothetical operators are modelled. These six cases are summarised in Table 3.1.

Table 3.1: Construction of operator cases

Proportion of revenue from	GB only operators			Global operators		
	Case 1	Case 2	Case 3	Case 4	Case 5	Case 6
Betting/Gaming	50/50	100/0	0/100	50/50	100/0	0/100

3.13 Figure 3.1 shows where the six case studies could be located in a gambling market space that locates operators according to the relative shares of betting to gaming and British to rest of the world customers.

Figure 3.1: The operator cases in gambling market space



3.14 In practice, most of the remote-gambling operators that British customers currently deal with are likely to be more centrally located on the horizontal axis than the six cases assume. These operators are likely to receive more than 6 per cent of their revenues from British customers, the share that would correspond to the assumed proportion of the global remote gambling market that is British.[42] But these operators are still likely to have a sizable proportion of their customer base being from outside Britain.

3.15 The case studies modelled do however allow attention to focus on two scenarios that might be of special interest to policy makers. If the interest is in making Britain the centre

[42] DCMS (2003) "The future regulation of remote gambling: a DCMS position paper" www.culture.gov.uk

for the global market, just how would a truly global operator (in terms of its customer base) respond to the rules being modelled? And do the conclusions change if the focus is solely on protecting British consumers, rather than on developing an industry to compete internationally? Will firms that only target British customers necessarily choose to locate in Britain (and thus be subject to British regulation)?

Modelling Assumptions

3.16 The model assumes that the operator's horizon is four years, and that over this time horizon no discounting takes place. These are simplifying assumptions; it would be possible to include discount factors and longer time horizons. But the longer the model extends into the future, the less plausible the assumption that the operator's location decision is irreversible. The entire business model of a remote-gambling operator could be reconsidered as assets need replacing and service agreements with third parties need renewing.

3.17 For all six cases, the model assumes that the operator's total gambling turnover in 2004 was £400 million, and that in the absence of the Gambling Bill this will increase by £100 million each year so that turnover has doubled by 2008. As far as the results are concerned, what matters is the assumed size and growth of the operators' turnover relative to relocation and other costs modelled. Otherwise, the size of turnover does not affect the qualitative results.

3.18 The assumed relocation costs are greater if the operator chooses to relocate all its assets outside Britain, than if it chooses to relocate into Britain. Relocating all the operations outside Britain is assumed to cost £5 million, twice the £2.5 million it is assumed to cost to relocate back into Britain. The figures are in line with estimates companies provided Europe Economics, including the discrepancy according to which operations need relocating.

3.19 The model assumes that the costs of duplicating operations are zero in option 3. This implicitly assumes that there are no economies of scale. The assumption should bias firms towards choosing option 3 (splitting into a British company and a rest-of-the-world company).

3.20 The total turnover for each of the four years is converted into gross win figures. The model assumes a margin of 10 per cent on remote-betting turnover and 4 per cent on remote-gaming turnover. These margins are assumed to be independent of where the operator is based.

3.21 However, the tax treatment differs depending on whether the operator locates in Britain or not. The gross win accruing to an operator based in Britain is assumed to be subject to a 15 per cent tax, corresponding to the current gross profits tax that applies to betting. The model assumes no corporation taxes would apply.

3.22 The model includes Value Added Tax liabilities for remote-gambling operators located in the Great Britain, where gambling has VAT-exempt status. Payments for software licences and advertising expenditures (but not promotional expenditure) are assumed to incur a VAT charge of 17.5 per cent. The model assumes that advertising expenditure is 1.5 per cent of turnover, *i.e.* £6 million in 2004 rising to £12 million in 2008. The operator is assumed to outsource all advertising, so that it is all subject to VAT. For an operator located exclusively in Britain, this would result in a total VAT liability of about £6.8 million between 2005 and 2008. For options 3 and 4, where the operator is only partially based in Britain, the advertising expenditure subject to a VAT liability is pro-rated according to the share of revenues its British-based entity earns.

3.23 Payments for software licences are usually set as a percentage of gross win. All software for remote gaming is assumed to be outsourced. The model assumes remote-gaming operators pay 20 per cent of gross win to their software providers. This gives rise to a VAT liability equivalent to 3.5 per cent of gross win (17.5 per cent of 20 per cent of gross win). Remote-betting operations are assumed to make more use of in-house software (which is exempt from a VAT charge). To capture this, the model assumes that the software licence payments subject to VAT for remote-betting operators are only 10 per cent of gross win. Consequently remote-betting operators' VAT liability for software licenses is 1.75 per cent of gross win (17.5 per cent of 10 per cent of gross win).

3.24 It is assumed that operators based outside Britain pay no VAT. The tax on gross win is also assumed to be zero. This corresponds to the rate that applies in some of the jurisdictions discussed in section two, but lower than the rates that would apply in others. Nevertheless, the assumption captures the fact that all of the other jurisdictions have gaming taxes considerably lower than those that would apply in Britain. Moreover, it compensates for the fact that the model does not include other forms of tax, such as corporation tax, that would tend to increase the comparative attractiveness of locations outside Britain.

3.25 The model assumes that gross turnover will be lower if the operator forms separate businesses for remote betting and remote gaming, i.e. chooses option 4. Operators have commented that having a single account for betting and gaming is very beneficial, especially for gaming registrations. A high proportion of their new gaming customers already hold a betting account. The model assumes that compared to an integrated betting and gaming operator, the separate entities would attract only 90 per cent of the betting turnover and 50 per cent of the gaming turnover.

3.26 The model also assumes that turnover is adversely affected if the operator is based outside Britain. Operators not based in Britain are assumed to attract only 50 per cent of the revenue they would earn if they were based in Britain. The rationale for this assumption is that there will be effective advertising restrictions on operators based outside Britain. The assumption may overstate the advantage to being based in Britain, since operators could avoid any advertising ban by choosing locations in the EEA such as Malta. Moreover, the extent to which the ban can be effective is questionable given the ability for operators to advertise on the internet in jurisdictions outside Britain.

3.27 There are other assumptions that arguably make Britain more attractive than it might otherwise be. As alluded to above, the assumptions about taxes probably understate the advantages of choosing locations outside Britain by ignoring corporation tax, etc. Furthermore, the model ignores the possibility that operators in lower tax environments will use this competitive advantage to attract more customers, by increasing the payout rates to levels that are unsustainable for British operators of the same size.

3.28 Nor is there any attempt to consider the differences between locations in operational costs. Other than outsourced software costs and advertising expenditure, the model assumes no operational costs. If operational costs were included in the model, including the costs of complying with local regulations, Britain is likely to be a relatively more expensive place to conduct business.

Table 3.2: Key assumptions for the analysis

Item	Assumed value
Total potential turnover for the operator in 2004	£400 million
Annual growth of potential turnover	£100 million
Advertising expenditure as a share of turnover	1.5%
Betting gross win margin	10%
Gaming gross win margin	4%
Betting tax rate in Britain	15%
Betting tax rate everywhere	0%
Gaming tax rate in Britain	15%
Gaming tax elsewhere constant.	0%
Relocation cost into Britain	-£2.5 million
Relocation cost out of Britain	-£5 million
Duplication cost	0
Value added tax	17.5%
Software licence payments, remote-gaming operator, as a share of gross win	20%
Software licence payments, remote-betting operator, as a share of gross win	10%
Turnover multiplier if promotion banned (for operators based outside Britain):	0.5
Betting turnover multiplier if single account not viable (for option 4):	0.9
Gaming turnover multiplier if single account not viable (for option 4):	0.5

Results and Implications

Preferred options of the operator

3.29 To assess how attractive the various options are to an operator, profits are calculated as the gross win margin from turnover less any gambling taxes and costs.

3.30 Table 3.3 presents the profits that would accrue under the four different options for each of the six operators. The option of separating into a British and a global business is not considered for cases 1–3; since an operator in these cases only serves British customers, option 3 will always be dominated by either the option to locate exclusively in Britain (option 1) and/or the option to locate entirely outside Britain (option 2). Similarly, the possibility of setting up separate betting and gaming businesses are not considered for the four case studies in which the operator's turnover is assumed to come exclusively from remote-betting or exclusively from remote gambling.

Table 3.3: Pay-offs from the options using the baseline assumptions (£m)

Option	Case 1	Case 2	Case 3	Case 4	Case 5	Case 6
Option 1	**78.9**	**144.6**	15.6	78.9	114.6	15.6
Option 2	54.8	92.5	**22.1**	**111.0**	184.2	**42.9**
Option 3	-	-	**-**	109.8	**187.0**	40.1
Option 4	70.3	-	-	75.5	-	-

3.31 The results are intuitively appealing. The mix of British or non-British and betting or gaming customers that an operator serves is important. An operator with an exclusively British customer base will choose to locate in Britain, unless it serves mostly gaming customers. Operators that only offer remote gaming and operators with a large overseas customer base will locate outside Britain. This will entail operators moving their remote-betting operations out of Britain. Operators that serve a global customer base and only offer remote betting should establish separate operations for their British and overseas accounts, given the assumed marketing disadvantages of locating fully offshore and the tax implications of being in the UK (although the model would suggest that assuming the operator was located in the UK prior to the Gambling Bill's enactment implied commercially suboptimal behaviour).

3.32 Setting up separate remote-betting businesses and remote-gaming businesses is never the most profitable option. The assumed marketing disadvantages of this option are too great. The model predicts that operators with a remote-betting business in Britain and remote-gaming business elsewhere would comply with the assumed regulations by relocating parts of their operations, and not just restructure the company.

Tax implications

3.33 Table 3.4 shows the gambling tax revenues that the government would receive for each possibility. Not surprisingly, revenues are greatest if operators choose option 1, i.e. locate all their operations in Britain.

Table 3.4: Gambling tax revenue from the options (£m)

Option	Case 1	Case 2	Case 3	Case 4	Case 5	Case 6
Option 1	**38.2**	**50.4**	26.1	38.2	50.4	26.1
Option 2	0.0	0.0	**0.0**	**0.0**	0.0	**0.0**
Option 3	-	-	**-**	2.3	**3.0**	1.6
Option 4	23.0	-	-	23.0	-	-

3.34 The more relevant consideration is what the tax revenues will be given the option that operators are most likely to choose, and how this compares with the tax revenues that might accrue if the Gambling Bill is not passed. Policy makers will not get to choose where remote-gambling operators locate their operations; instead they set policies that influence that decision. The results of the model suggest that operators with a large customer base outside Britain or that engage mostly in remote gaming will choose options 2 or 3 (*i.e.* base all or some of their operation outside the UK), which results in considerably less tax for Britain government than if they were wholly based in the UK, (as under option 1).

3.35 Significantly, the tax revenue of the government could be less under the Gambling Bill than that under status quo.

3.36 This is most likely to be true for operators serving the global market and for whom gaming is a relatively more important source of revenue than betting. To demonstrate this point, consider an operator whose revenues are split 10/90 between remote betting and gaming. Under the current regulations, the operator has three choices. Relocating all its operations outside Britain (option 2), separating into separate remote-gaming and remote-betting businesses (option 4); or continuing as it currently operates, with its betting operation in Britain and its gaming operations overseas with some shared facilities (denoted as option 0 in the table). The current regulatory environment in Britain banning remote-gaming operators mean that options 1 and 3 are not available to the operator. The operator prefers option 0, carrying on as it currently does. This avoids the relocation costs associated with option 2 and maintains the marketing advantage associated with offering customers a single account for both gaming and betting which option 4 does not have.

Table 3.5: Pay-offs and taxes for a global operator with 10/90 betting-gaming split (£m)

Option	Status quo		Gambling Bill	
	Pay-offs	Tax contribution	Pay-offs	Tax contribution
Option 0	**54.2**	**5.0**	-	-
Option 1	-	-	28.3	28.5
Option 2	52.5	0.0	**52.5**	**0.0**
Option 3	-	-	50.1	1.7
Option 4	32.2	4.6	32.2	4.6

3.37 In contrast, if the Gambling Bill takes effect as modelled here, the operator would choose option 2 relocating fully offshore. The government would loose all tax revenues from these operators, and perhaps more importantly, British regulatory oversight on the sector will fall.

Sensitivity analysis

3.38 The results obviously depend on the assumptions made. Many of the assumptions perhaps bias the results in favour of locating in Britain (either option 1 or option 3). The assumptions about tax liabilities probably understate Britain's comparative disadvantage to many other leading jurisdictions for remote gambling.

3.39 The option of locating entirely outside Britain would also become more attractive if the assumptions concerning demand were changed. The model currently assumes that the difficulties of attracting British customers for operators outside Britain will be severe, and that operators based in Britain will not find that the larger tax burden affects their ability to attract customers in the competitive global market.

3.40 Just relaxing the model's assumption about the marketing disadvantage associated with locating operations out of Britain significantly affects the results. Keeping everything else constant and assuming that turnover from British customers only falls by 20 per cent rather than 50 per cent if based outside Britain after the Gambling Bill comes into force, the model predicts that the operator will locate all their operations outside Britain (option 2). This is for all six case studies, including the three where the operator only has a British customer base.

Table 3.6: Pay-offs if the marketing penalty for non-British operators is smaller (£m)

Option	Case 1	Case 2	Case 3	Case 4	Case 5	Case 6
Option 1	78.9	144.6	15.6	78.9	144.6	15.6
Option 2	**90.7**	**151.0**	**35.4**	**113.2**	**187.7**	**43.7**
Option 3	-	-	-	109.8	187.0	40.1
Option 4	73.6	-	-	75.7	-	-

3.41 Changing the assumptions about other possible costs, including duplication costs associated with setting up two separate operations, can change the ranking of the options as well. The model assumes duplication costs are zero. If instead it was assumed that the costs were £3 million, a global operator (regardless of the relative importance of gaming and betting to turnover) would choose to run a single firm. Of most interest from a policy perspective, all the operations would be located outside Britain: option 2 would be most attractive.

Implications

3.42 Perhaps the main conclusion to draw from the modelling exercise is just how poor the financial incentives are for remote-gambling operators to locate all their business in Britain. The assumptions tend to bias the results towards favouring locating in Britain, yet the model predicts that operators are unlikely to locate their entire operations in Britain unless they deal almost exclusively with British customers and betting is a significant part of their turnover.

3.43 Even then, the attractiveness of Britain depends critically on the assumed difficulties that remote-gambling operators will have after the Gambling Bill attracting British customers if they are based outside Britain. The model arguably overstates these difficulties. There will be difficulties enforcing any ban on advertising from outside Britain, given that the medium remote gamblers use (*i.e.* the internet) means that they will be exposed to many adverts placed outside Britain. Moreover, operators could always choose to locate in jurisdictions where no such ban on advertising applied, such as those in the EEA. The fact that operators can and may choose to locate in venues such as Malta should perhaps also serve to remind policy makers that the intangible advantages, such as policy stability, that Britain might once have enjoyed when seeking to attract remote-betting operators are becoming less and less significant.

3.44 It only takes a relatively small share of non-British customers for the operator to no longer find it most profitable to locate entirely within Britain, even if the assumed difficulties in attracting customers from overseas are as great as the model assumes. An operator with an equal split of betting and gaming revenues would only prefer locating all operations in Britain if less than 13 per cent of its customers were from overseas.

4 CONCLUSIONS

4.1 The previous chapter illustrates the potentially strong financial incentives for remote-gambling operators to locate their business outside Britain. Relating this back to the criteria discussed in the introduction, the proposed regulations run the very real risk of not being effective given the potential tax regime in place.

4.2 The effectiveness criterion means that the regulatory measures adopted should help achieve the objectives of regulation, with a high degree of compliance and minimal risks of evasion and avoidance of such regulation. Yet considerable evasion and avoidance of the British gambling regulation seems very plausible.

4.3 It is unlikely that remote-gambling operators seeking to compete internationally will relocate all their business into Britain. The government's hopes of Britain being the centre for this industry will not be realised. Moreover, it will potentially even fail to achieve the goal of protecting British consumers. Remote-gambling operators located elsewhere will not be subject to the regulations that the British authorities deem appropriate as consumer protection measures; large numbers of British consumers are still likely to use operators located in other jurisdictions.

4.4 The Bill may be worse than ineffective in realising regulatory goals for remote gambling. If it leads to operators relocating their remote-betting operations outside Britain, the government will have less regulatory oversight than before and Britain's position in the global betting market will have worsened.

4.5 The government should give serious thought to how it proposes to tax the sector; the taxes cannot be set without reference to the regimes in place elsewhere. Nor do decisions on taxes just affect the Treasury's tax receipts. They determine whether or not remote-gambling operators choose to be licensed and regulated by British authorities. Other viable jurisdictions impose much lower taxes on remote gambling than Britain, and operators based in Britain could struggle to cope in such an environment.

4.6 There is a strong case for developing an approach to taxing remote gambling in conjunction with the work being done now to design an appropriate regulatory regime for Britain. In an industry where firms are internationally mobile, taxes can affect regulatory effectiveness and regulations can affect tax revenues. The rules governing VAT means that UK-based operators will already face the equivalent of a 3 per cent tax on gross win before any specific gambling duty is charged; this 3 per cent already exceeds the tax liability on gross win operators would face in many other jurisdictions targeting remote-gambling operators.

4.7 The concerns with requiring all operations to be located in Britain are not limited to doubts about their effectiveness. Remote-gambling operators that would locate entirely in Britain if that was a condition of being licensed here might nevertheless have a legitimate complaint that such a regulation is not proportionate or targeted.

4.8 To be proportionate, "policy solutions must…justify the compliance costs imposed."[43] In justifying the costs, thought must have been given to all the other options available to realise the policy objective. Relocation costs are not negligible. The assumption used in the preceding chapter of £2.5 million was made following feedback from operators. There are other important considerations when thinking about proportionality. For example, as well as the costs of relocating, any ongoing disadvantage associated with being based in Britain should be included.

4.9 The government has already recognised that "there may be good commercial reasons why gambling companies will wish to put part of their operation on servers located overseas".[44] In some instances, operators may have contractual arrangements in place that require part of their operations be overseas. This may be particularly relevant when thinking about multi-player remote gaming, most notably online poker, continually increasing in popularity and importance. Having a large pool of potential players, ideally across all time zones, has the advantage of meaning that users are likely to be able to find other players at any time of the day or night. Consequently, it is not unusual for remote-gambling operators to share a server for such activities. Those with a small British customer base will be unwilling to relocate to Britain. Smaller remote gambling operators seeking a licence in Britain may be forced to abandon multi-player remote gaming; and the long-run consequence may be the creation of a significant entry barrier for British-based operators wishing to enter the multi-player remote-gaming market.

4.10 There are alternative regulatory arrangements that could realise the government's goals that do not require all the operations to be located in Britain. For instance, to guarantee that licensed British operators use appropriate RNGs and honour winning bets, the Gambling Commission might consider using independent third-party auditors—PwC already audits payout rate for some major remote gambling operators.[45]

4.11 A proposal to require all operations be located in Britain can also be criticised for not being targeted. As the Better Regulation Task Force has noted, regulations "should focus primarily on those whose activities give rise to the most serious risks".[46] All of the controls on a remote-gaming operator that the government envisages in its position paper—screening of players, reality checks, responsible management, filtering services, and rules governing displays, rapidity of play, play for fun games, and payment methods—could be achieved without requiring any parts of the operations be in Britain.[47]

4.12 If the government is serious in its desire to make Britain a centre for remote gambling, it needs to ensure that the regulatory and tax environment is one that will make Britain a realistic, viable option for operators. If it does not, operators will choose one of the many

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43 Page 4, Better Regulation Task Force (2003) *Principles of good regulation*, www.brtf.gov.uk
44 Paragraph 88, DCMS (2003) "The future regulation of remote gambling: a DCMS position paper" www.culture.gov.uk.
45 www.pwcgaming.co.za/about%20pwc.htm
46 Page 6, Better Regulation Task Force (2003) *Principles of good regulation*, www.brtf.gov.uk
47 Paragraph 43, DCMS 2003) "The future regulation of remote gambling: a DCMS position paper" www.culture.gov.uk

alternative jurisdictions, within and outside the European Union, that are already making them welcome. Britain would miss the opportunity to host this fastest growing sector of the gambling industry, and to ensure British citizens can engage in an activity that is crime free, fair, open, and protects vulnerable people (including children).

4.13 Regulations that force operators to choose between locating wholly in Britain or wholly outside will, at best, attract operators whose business model focuses almost exclusively on the British market. They are not effective, proportionate, nor targeted.