

**Remote Gambling Taxation**  
**A report for the**  
**Remote Gambling Association**

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## **1 SUMMARY AND CONCLUSIONS**

- 1.1 One of the high-level objectives set by Government in the 2005 Gambling Act is to retain existing gambling in the UK and to attract new operators currently operating in other jurisdictions. Remote gambling operators frequently have both betting and gaming businesses, so, when it comes to tax, it is the assessment of their overall burden that will determine decisions they make about where to locate their operations. But, for convenience, this report analyses remote gaming separately from remote betting.

### *Remote gaming*

- 1.2 Remote gaming is not currently allowed on-shore in the UK, so UK-registered companies have to run their remote gaming operations offshore. All the major UK bookmakers are included in this group. International competition in remote gaming is intense. Furthermore, there are several overseas jurisdictions, some within the EU, some not, where remote gaming operators can choose to locate. In round terms, these jurisdictions offer nil or next-to-nil rates of tax on revenue, gross win or gross gaming yield, and nil or low corporation tax rates. UK (and many other) remote gaming operators have now acquired several years' experience of managing their businesses in these jurisdictions.
- 1.3 It is against this background of competition with each other and competition between governments to attract their business that remote gaming operators will need to consider the pros and cons of locating in the UK once it becomes possible after 2007. It is possible that, because of its reputation as a well-regulated jurisdiction which sets great store by gambling integrity, the UK may be able to command a small "tax premium" to attract new or established operators here. However, where relevant, VAT at 17.5 per cent and corporation tax at 30 per cent amount together to more than a small premium (although we acknowledge that the VAT and corporation tax positions of different companies may differ considerably). We calculate that a hypothetical remote gaming operator with a handle of £500 million, a gross gaming yield of £50 million and a corporation tax charge of £25 million (all hypothetical numbers) would suffer total taxation ranging from under £100,000 p.a. to about £1.3 million in all but one of the overseas jurisdictions which have sought to attract gambling businesses. Under the current UK tax régime for on-shore gaming, we calculate that the same operator would pay at least £18 million if he located in the UK, and possibly more depending in his input and output VAT.
- 1.4 In any event, one must allow for the likelihood that overseas jurisdictions that have attracted gaming operators will develop an improving regulatory régime and enhanced local management expertise which, over time, will match those of the UK. The UK probably has only a limited time in which to attract those companies to whom strong regulation and regulatory expertise are particularly appealing.
- 1.5 Our view is that in the light of established competition from no-tax/low-tax jurisdictions as domiciles for remote gaming, Government should not assume substantial tax revenues from its decision to allow remote gaming in the UK as from 2007. Of course, it may

legitimately feel that it wants to attract remote gaming in order to give UK and other consumers the benefit of the UK regulatory régime and reputation. Since Government policy is, wherever possible, to marry taxation policy to social policy this seems to us a very valid consideration.

*Remote betting*

- 1.6 From discussions we have had with UK-based bookmakers it is apparent that they will be influenced, in deciding whether to stay in the UK or to move their remote operations overseas, by decisions the Government makes in relation to betting taxation as a whole. UK operators clearly feel strongly that an understanding was struck in 2001 under which UK remote betting would remain in or be repatriated to the UK, in return for Government's commitment to a 15 per cent rate of GPT on betting. If the understanding is broken by material tax changes, some UK-based operators might consider moving all or part of their remote betting activities offshore. It would be easy to remove the internet-based betting quite quickly; removing a well-established telephone-based element would take longer but would by no means be impossible. In short, if the tax burden becomes too high across all products then some companies might have to consider moving all of their remote gambling business offshore, although such decisions would not be taken lightly.
- 1.7 Our estimate is that about 20 per cent of UK bookmakers' total gross win is currently accounted for by remote betting (it is difficult to be precise because the figures are confidential to each bookmaker, and not all bookmakers account for remote betting in the same way). If this 20 per cent is even approximately right, it follows that the same 20 per cent of GPT revenue would be lost to the UK. Allowing for the proportion of total GPT accounted for by betting exchanges, we calculate that the 20 per cent represented by remote betting is worth about £80 million p.a. At present, remote betting is divided roughly 60/40 as between internet and telephone (with interactive TV accounting for a negligible percentage at present). So, even on current numbers, some £42 million of GPT could disappear very quickly and the rest over a period of a year to two years.
- 1.8 The trend in recent years has been for remote betting to be the fastest growing part of the betting industry and the expectation is that it will be so for the foreseeable future. Continued growth means that potential revenue loss in the future will be even higher than current figures might suggest.
- 1.9 The loss of UK employment associated with the removal of telephone betting is estimated at about 3000.
- 1.10 We do not believe that, if UK-based remote gaming were taxed at very low levels and remote betting taxation were left as it is, there would be a backlash based on the differential. The evidence we have received is that bookmakers would accept a difference as unavoidable. We do not foresee that the National Lottery operator would object.

*Place of consumption tax*

- 1.11 We understand that the Government has mooted a place of consumption tax (POCT) as a means of allowing operators to pay no tax or low tax on overseas-originated gambling but to pay UK tax on gambling conducted by gamblers based in the UK. We further understand that POCT was considered as one option before Government decided in favour of GPT. If POCT was rejected then, it is surprising that it should resurface now. There may be reasons that we are unaware of for the Government's renewed interest in it, but in our view the practicalities would make it unworkable.
- 1.12 An example sometimes quoted of how the POCT concept can be made to work is the Insurance Premium Tax (IPT). In our view this is not a comparable precedent. IPT concerns a limited number of transactions involving large, visible corporations. For gambling one would need to find a mechanism which identified and policed millions of transactions involving millions of consumers. It is known to be relatively easy to use the internet in such a way as to conceal one's physical location and personal details, and it is inconceivable to us that operators would go to the extraordinary lengths required to identify every transaction by every gambler in order to establish where he or she was *in order solely to increase the operator's own tax liability*.
- 1.13 Furthermore, it would be necessary for governments to agree audit régimes of transactions in their own and other jurisdictions, and we suggest that this too would be impracticable if, as we have seen, there is tax-based competition between governments to attract gambling operators.
- 1.14 It has also been suggested to us that a "usual place of residence tax" (UPRT) could possibly be substituted for place of consumption, but that does not reduce the burden of transaction-checking on operators or incentivise them to do it. Far from securing increased tax revenue POCT and UPRT would be effective methods of handicapping the UK gambling industry.
- 1.15 The principle of POCT would also, we suggest, create such a level of uncertainty amongst gambling operators that they might cease to consider the UK as a safe jurisdiction. It would leave them open to the threat that other jurisdictions, including those with domestic gambling monopolies, will seek to impose high tax rates on whatever business UK based operators were taking from their residents. This would take place at a time when all those direct competitors who had remained offshore would continue to operate with little or no comparable tax burden.

*In summary...*

- 1.16 If Government wishes to attract and then retain remote gaming in the UK it will, we believe, have to provide a no-tax or low-tax régime and, even then, it will need to acknowledge the additional tax burden that could be placed on operators by VAT and

corporate tax. If it wishes to retain remote betting in the UK, it will in our view need to ensure that the GPT rate does not exceed the current 15 per cent.

- 1.17 While we have explained that remote gambling operators must consider the totality of their businesses, it is possible to treat remote betting, remote gaming, bricks-and-mortar betting and bricks-and-mortar gaming differently for tax purposes. If the Government is concerned that the remote gambling industry will use a lower rate of GPT on gaming to argue for a lower rate on betting then we believe that its fears are unfounded. The remote betting sector regards GPT at 15 per cent as part of an understanding with Government reached four years ago. As this report shows, the case for a lower rate of GPT on remote gaming is justified by a distinctly different set of circumstances.

## 2 BACKGROUND TO THE STUDY

- 2.1 In September 2005 the Remote Gambling Association (RGA) asked Europe Economics (hereinafter “we” or “us”) to undertake an independent study of the UK tax régime as applied to remote gambling. For purposes of this report the term remote gambling covers gambling conducted by telephone, over the internet, or via interactive TV. Gambling may conveniently be broken down into betting (for example, backing a horse or wagering on the outcome of a football match) and gaming (for example, playing poker by joining an on-line poker room).
- 2.2 The study we were asked to undertake is, we understand, in the context of a general review of gambling taxation that H.M. Treasury is conducting ahead of the Chancellor’s 2005 autumn statement. RGA told us that Treasury officials have made it clear that the 2006 Budget is likely to make major changes to gambling taxation.
- 2.3 The deadline set for our report was tight. This has meant that we have not been able to research background statistics as thoroughly as we normally aim to do. We are satisfied that the analysis and conclusions we have reached are robust, but we would be glad to reinforce this report with further research if RGA so requires.
- 2.4 As broad background the Government has made it clear that it wants to see a thriving, innovative gambling sector in the UK. It has consistently adopted this stance since commissioning the review of gambling, published in 2001, that was led by Sir Alan Budd and his team. The Government’s response in 2002, *A Safe Bet for Success*, reinforced this same message, and the Gambling Act 2005 enshrined in law a number of important recommendations made by Budd. Chief among the innovations in the Act is the creation of a Gambling Commission, whose principal task will be to create and police a new, more harmonised regulatory régime for gambling.
- 2.5 Two key concerns of Government in connection with the creation of a new regulatory régime are that:
- the UK should retain existing gambling activity and attract new operators;
  - gambling should be conducted in a fair, open and transparent way.
- 2.6 The Government also wants to see protection given to children and the vulnerable. We do not believe that this concern is directly affected by taxation. However, if, for tax reasons operators move to or remain in offshore jurisdictions where the social responsibility requirements may be thought less stringent than in the UK, then the Government is likely to fail in this particular objective.
- 2.7 From the outset we doubted that the taxation of remote gambling could sensibly be considered in isolation from non-remote, variously referred to in the industry as “conventional” or “bricks-and-mortar” or “over the counter” gambling. This is because:

- some major UK operators of remote gambling are also active in non-remote
- large numbers of consumers have a choice of whether to gamble remotely or otherwise

2.8 Since, in general, consumers may participate in betting or gaming without being taxed on their stakes or winnings, it may be thought that tax régimes do not affect the preferences of consumers. But different tax régimes may give operators incentives to market their different products in different ways, so to that extent tax does have an effect, albeit indirect, on consumers.

2.9 For the record, we should add that we are also advising the Association of British Bookmakers (ABB) on the tax review. ABB represents bookmakers in their non-remote betting operations. The taxation régime for remote gambling, even if it is split between remote betting and remote gaming, needs to be considered on its own merits, but some remote gambling operators have to factor in what is happening in other parts of their businesses too. At certain points, therefore, this report cross-refers to our work for the ABB, and *vice versa*.

### **3 THE REMOTE GAMBLING MARKET**

#### **Some basic facts and figures**

- 3.1 Remote gambling takes many forms, including casino table games (such as poker, blackjack, and roulette), lotteries, and betting on horse races, greyhound races, and sports events.
- 3.2 Remote gambling can currently be practised on three principal platforms, namely the telephone, the internet, and interactive television. Television accounts for only a tiny percentage of remote gambling at present – well under 1 per cent in the UK and lower elsewhere. Telephone-based gambling has traditionally been used for betting, not for gaming, although increasingly sophisticated mobile phones with colour screens open up new possibilities. The real engine of growth has been the internet.
- 3.3 The remote gambling industry is still considered to be in its infancy, yet already it generates significant annual revenues worldwide. It is also attracting a great deal of research and market estimates. The latter vary widely as to how large the global market already is, how big it will become, and how it will split between different geographic markets and different form of gambling.
- 3.4 DCMS estimates that there are currently around 1,700 on-line gambling sites worldwide, and that 15 million on-line gamblers are expected to generate a turnover of \$30 billion in 2005.<sup>1</sup> This would be double the turnover of just four years earlier; when 2001 global remote gambling turnover was estimated at \$15 billion.<sup>2</sup>
- 3.5 In 2002, 55 per cent of on-line gambling market revenue came from on-line casinos, 43 per cent came from on-line sports/events betting, and the remaining 2 per cent came from lotteries.<sup>3</sup>
- 3.6 On-line poker has become particularly important to operators' commercial success. It is perceived as a game requiring more skill than other, machine-based forms of remote gaming, and has enjoyed popularity with people across all age and social groups.
- 3.7 The United States currently represents the largest individual national market for on-line gambling, with more than four million on-line gamblers and \$7.6 billion on-line gambling revenue expected in 2005.<sup>4</sup> But the Asia-Pacific region as a whole is also large and fast-growing. It accounted for 57 per cent of gamblers and 59 per cent of on-line gambling

<sup>1</sup> DCMS (2003) "The future regulation of remote gambling: a DCMS position paper" [www.culture.gov.uk](http://www.culture.gov.uk)

<sup>2</sup> [www.microgaming.com](http://www.microgaming.com)

<sup>3</sup> [www.microgaming.com](http://www.microgaming.com)

<sup>4</sup> [www.microgaming.com](http://www.microgaming.com)

revenues in 2002, and one source estimates that there will be 7.7 million Asia-Pacific on-line gamblers by the end of 2005.<sup>5</sup>

- 3.8 Although the European on-line gambling market has fewer customers and generates less revenue than the US or Asia-Pacific, it has become increasingly attractive to remote-gaming operators. This is because of its significant potential for growth, the gradual acceptance of remote gambling, and the emergence of more favourable regulatory régimes (the UK being just such an example). It is expected that by 2005 there will be 3.3 million on-line gamblers in Europe, over a quarter of them (0.9 million) in the UK.<sup>6</sup>
- 3.9 The size of the remote-gambling market worldwide has attracted a large number of operators, and competition to attract and retain customers is fierce. The international nature of poker and of other casino-type games means that customers can easily switch between operators. The operators we have spoken to for this study have reported a constant need to compete aggressively. The margins generally enjoyed in remote gaming are small, with the payout percentage in the high 90s, often around 98. It is not surprising that customers find on-line gaming attractive: high percentage returns to gamblers mean that, on average, a given stake will last longer than when the operator keeps a higher margin.
- 3.10 Competition is not confined to the payout ratios. Operators frequently run 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.<sup>7</sup> Against that assessment, attractive promotional offers are unsurprising.

## **Competitive Pressures**

- 3.11 The fierce competitiveness of remote gambling is only to be expected. The available market is large and growing; and where regulation allows it, the barriers to entry and exit are small. Many of the components required to provide remote gambling can easily be sourced from other providers should the operator so prefer.
- 3.12 The core component of a remote gaming operation is a server and suitable software to provide gambling functionality. For remote gaming, it is the generation of (random) numbers that forms the basis of the events on which customers wager. Thus, 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. on-line roulette or blackjack, the different games do not usually present large IT challenges.

<sup>5</sup> International Gaming and Wagering Business (2002) "Internet gaming: an industry survey" [www.microgaming.com](http://www.microgaming.com).

<sup>6</sup> International Gaming and Wagering Business (2003) "New trends in on-line gaming" [www.microgaming.com](http://www.microgaming.com)

<sup>7</sup> International Gaming and Wagering Business (2003) "New trends in on-line gaming" [www.microgaming.com](http://www.microgaming.com)

- 3.13 Although many sites use proprietary software, a number of providers are available for businesses that decide not to develop the software in-house. The gaming 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. Gaming software providers are also able to offer “one-stop” services ranging from system design and implementation to daily maintenance and support.
- 3.14 Entrants are able to avoid large up-front investments in acquiring software; thus they do not need to expose themselves to large financial risks should the venture prove unsuccessful. Royalties are a variable cost related to turnover rather than a sunk cost.
- 3.15 Specialists such as NETeller make it easy for on-line operators to arrange a payment system so that they can receive deposits and pay winnings to customers remotely. 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.
- 3.16 Remote gambling, and especially remote gaming, is thus characterised by relatively easy entry and exit. In some geographic areas the availability of skilled staff may represent a problem, but, given the ready availability of outsourcing and specialist advice, this is not an enduring barrier to entry, and may be overcome by training.
- 3.17 Remote gaming in particular is also characterised by thin gross margins. Where operators outsource a large proportion of services, then net margins too become very thin as service providers take a fee related to gross profit.

### **Choice of location**

- 3.18 Competition among operators increases the importance of decisions such as where they choose to locate a remote gambling business. Any marginal advantage an operator can gain by choosing a better environment to locate the business will be especially important. Jurisdictions with favourable tax régimes will be especially attractive.
- 3.19 The website GamblingLicenses.com identifies four key factors that influence where remote-gambling operators decide to locate.<sup>8</sup>

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

<sup>8</sup> [www.gamblinglicenses.com](http://www.gamblinglicenses.com)

- (b) *Regulatory structure.* The existence of regulation is not a deterrent: indeed it can be attractive, since reputable operators will often place a value of being licensed in a jurisdiction which sets high standards of integrity. Tax rates and the cost of licences (including the costs of satisfying licence terms) have a major impact too. Some jurisdictions are more attractive than others simply because obtaining information and dealing with competent regulatory bodies is easier and quicker.
- (c) *Policy stability.* How stable is the political environment and what form are changes to policies governing interactive gaming likely to take?
- (d) *Telecommunications facilities.* Remote operators will need to be satisfied about the availability, reliability and cost of communications, especially (though not only) internet access, adequate bandwidth, the availability of leased lines and satellite communications.

### **The United Kingdom**

- 3.20 The UK fares well against these criteria – except of course in its historical refusal to allow on-line gaming to be based in the UK, a position which is due to be reversed in 2007. The UK's advantages include a stable political system, an adequate infrastructure, and an increasingly favourable regulatory structure for gambling. Remote betting operators are already well established in the UK.
- 3.21 But it cannot be assumed that Britain's attractions to remote betting will automatically transfer to remote gaming. The remote betting operations of UK bookmakers grew out of their over-the-counter betting businesses, and were confined initially to telephone betting. UK law has forced them to locate their remote gaming operations overseas, with the result that they, and very large numbers of other remote gaming operators, have now acquired substantial experience of non-UK jurisdictions.
- 3.22 Other jurisdictions (as we show below) share the UK's goal of becoming attractive centres for gambling, both remote and non-remote, and are starting to construct their tax and regulatory environments accordingly. Low-tax and no-tax competition is the reality that UK policy makers have to confront.
- 3.23 The UK's attractiveness as a venue for remote gambling cannot be taken for granted. Taxes levied directly on gambling (e.g. on gross win or gross gaming yield) together with, where relevant, VAT and relatively high levels of corporate tax, set the UK at a major disadvantage, especially in attracting global operators that have no particular affinity with or established stake in the UK.
- 3.24 In the following paragraphs we consider a number of jurisdictions which compete with the UK as potential locations for remote gaming operators. We have chosen for this report the locations to which GamblingLicenses.com awards its top rating of four stars.

## **Malta**

- 3.25 Malta's recent admission to the EU 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. Malta already hosts remote gambling operations. The fact that the OECD does not classify Malta as a tax haven may also be an advantage from reputation point of view.
- 3.26 The Malta Lotteries and Gaming Authority (LGA) is responsible for licensing firms in the gambling industry. Remote gambling operators may seek on-shore status 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 (which is not a problem for any remote operator).
- 3.27 There are four classes of licence of potential interest to remote-gambling operators:
- (a) Class 1 — on-line gaming;
  - (b) Class 2 — on-line betting office or on-line betting exchange;
  - (c) Class 3 — to promote betting and gaming from Malta;
  - (d) Class 4 — host and manage third party on-line gaming operators.<sup>9</sup>
- 3.28 In sterling terms licences cost about £4,800 per annum.<sup>10</sup> In addition, the initial application for a licence is subject to a non-refundable application fee of about £1,600, and renewing the licence costs roughly £800.
- (a) The total gambling duties payable by a licensed operator (regardless of how many licences he has) are capped at roughly £320,000.
- 3.29 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.<sup>11</sup>

<sup>9</sup> [www.gamblinglicences.com/LicensesDatabaseDetail.cfm?LicensesID=40&Region=Europe](http://www.gamblinglicences.com/LicensesDatabaseDetail.cfm?LicensesID=40&Region=Europe)

<sup>10</sup> All exchange rates used in this paper were taken from [www.xe.com](http://www.xe.com) on 5 January 2005.

<sup>11</sup> [www.ateon-line.co.uk](http://www.ateon-line.co.uk)

## **Isle of Man**

- 3.30 The Isle of Man operates a low income tax system, has close cultural ties with the UK, and has reliable infrastructure.
- 3.31 It 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. The island has developed a new regulatory framework for remote betting and gaming operations after failing to attract US operators. 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.
- 3.32 A number of incentive schemes exist for locating business in the Isle of Man. They include financial grants of up to 40 per cent of capitalised costs for equipment, marketing, relocation and professional fees. Grants can rise to 50 per cent for training, and can be applied for on annual basis.<sup>12</sup>
- 3.33 The island’s new strategy for attracting e-gaming business combines the established regulatory arrangements with lowered licence fees – annual licence fees are now £35,000, with an application fee of £1,000.
- 3.34 To allow advertising in British media, the Isle of Man levies a 15 per cent duty on betting yield from inside Britain and a 10 per cent duty on betting yield from the Isle of Man. Betting yield from elsewhere is subject to a 1.5 per cent duty. The duty levied on gross gaming yield is progressive, with rates ranging from 0.5 per cent to 2.5 per cent. On-line gambling in the Isle of Man is not subject to VAT.<sup>13</sup>
- 3.35 The Isle of Man authorities issued a concession in April 2005 applying a zero rate of corporate tax (“income tax” as called in Isle of Man) on company trading profits in respect of on-line gambling.<sup>14</sup> There are tax allowances for capital expenditure, and dividends to shareholders are tax deductible.<sup>15</sup>

## **Alderney**

- 3.36 The regulatory régime for gambling in Alderney is generally regarded as rigorous but light-handed. When applying for a gambling licence the applicant must deposit £15,000; this is

<sup>12</sup> [www.incpardise.com/offshore/isle2.htm](http://www.incpardise.com/offshore/isle2.htm)

<sup>13</sup> [www.gov.im/gambling/guidance/VAT.pdf](http://www.gov.im/gambling/guidance/VAT.pdf)

<sup>14</sup> <http://www.gov.im/lib/docs/gambling/onlinegamblingzerorateoftaxo.pdf>

<sup>15</sup> [www.gov.im/treasury/](http://www.gov.im/treasury/)

refundable to the extent that the application processing costs less, but is subject to increase if the processing proves to be more expensive.<sup>16</sup>

- 3.37 The annual licence fee, either for interactive gaming or for electronic betting, is £75,000. The fee for the Certificate of Prior Approval (for other gambling) is £30,000.
- 3.38 Alderney has no VAT or gaming taxes, and personal income tax is low, with a top rate of 20%. The top rate of corporation tax is currently 20 per cent but Alderney is planning to eliminate corporation tax by 2008.
- 3.39 The decision of Rank Interactive to move its operation from the Isle of Man to Alderney in 2003 provides evidence that remote gambling operators do move as jurisdictions offer a more favourable environment.

### **Gibraltar**

- 3.40 Gibraltar has clearly proved to be an attractive site for remote gambling operators. The generality of British bookmakers had located their remote betting activities in Gibraltar prior to the UK government's switch from GBD to GPT in 2001.
- 3.41 Gibraltar enjoys a multi-lingual labour force, well developed telecommunications, and a legal framework based on English common law. Crucially, for gambling purposes, Gibraltar is classed as part of the European Union with all the benefits which that entails, including the ability for operators to advertise in the UK and accept business from UK-based customers.
- 3.42 All gaming operations in Gibraltar require licensing under the Gaming Ordinance. The Office of the Financial and Development Secretary issues licences for gaming and for telephone and internet betting. The licence application fee is £2,000.<sup>17</sup> Gibraltar is also in the process of reviewing its gambling laws so that the regulation of remote gambling operators is modernised. We understand that that review has the support of gambling operators currently located there.
- 3.43 Gaming tax is currently levied at 1 per cent of turnover for sports betting and 1 per cent of gaming yield (drop) for internet casinos. The minimum tax contribution must be £85,000, but the maximum is capped at £425,000 per annum per licence. Gibraltar does not apply any sales tax or VAT.<sup>18</sup>

<sup>16</sup> [www.gamblingcontrol.org/docs/51.pdf](http://www.gamblingcontrol.org/docs/51.pdf)

<sup>17</sup> Page 9, Interactive Gaming, 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](http://www.iggba.org.uk/html/graphics/remote_gambling_and_uk_taxation.pdf)

<sup>18</sup> [www.gibraltar.gov.gi/gov\\_depts/internet\\_gaming/internet\\_gaming.htm](http://www.gibraltar.gov.gi/gov_depts/internet_gaming/internet_gaming.htm)

- 3.44 Any Gibraltar-registered company that is owned by non-residents and does no business with residents can apply for exempt or qualifying status. Companies that obtain exempt status do not pay tax on income, nor do they pay withholding tax on dividends or interest. Instead, they must pay an annual fee to maintain exempt status of £225. An exempt company may have local offices, employ local staff, use local banks and have its central management in Gibraltar.<sup>19</sup> A company with qualifying status may negotiate a tax rate with the government of between 0 per cent and 35 per cent (the standard rate of tax for resident companies).

### **Antigua**

- 3.45 A number of Caribbean jurisdictions have already become centres for on-line gambling. Licences cost US\$75,000 (about £40,000) for interactive gaming and US\$50,000 (about £27,000) for interactive wagering.<sup>20</sup> Licence holders are subject to software checks for fairness, and due diligence checks on holding companies and individuals. Interactive betting and gaming is in theory subject to a 3 per cent tax on the gross handle, though we understand that in practice operators have not been required to pay it. Foreign corporations may avoid Antigua's 40 per cent corporation tax rate by repatriating profits, and they are eligible for a 15-year tax holiday.

### **Curaçao**

- 3.46 Curaçao already has a sizeable remote gambling sector. Cyberluck Curacao NV, a private company, holds the Master Licensing Authority. This allows it to issue unlimited numbers of licences to qualified internet gambling operators. The monthly licence fee is about £3,000.<sup>21</sup> Thereafter, operators are subject to a tax on profits capped at 2 per cent and they pay no import duties or turnover tax. There is also a special low income tax régime for expatriates working in e-gambling. Regulatory compliance costs for operators licensed in Curacao are close to zero.

### **Kahnawake**

- 3.47 The Mohawk Territory of Kahnawake in Canada has established a Gaming Commission that 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

<sup>19</sup> [www.gibraltar.gov.gi/index.htm](http://www.gibraltar.gov.gi/index.htm)

<sup>20</sup> [http://www.antigua-barbuda.com/finance\\_investment/incentives\\_for\\_investors.asp](http://www.antigua-barbuda.com/finance_investment/incentives_for_investors.asp), [www.antiguagaming.gov.ag/legislation2.asp](http://www.antiguagaming.gov.ag/legislation2.asp)

<sup>21</sup> [http://www.gamblinglicences.com/LicencesDatabaseDetail.cfm?Licenses\\_ID=30&Region=Caribbean](http://www.gamblinglicences.com/LicencesDatabaseDetail.cfm?Licenses_ID=30&Region=Caribbean)

£4,300) per year, with an initial application fee of C\$20,000 including a C\$5,000 non-refundable deposit.<sup>22</sup> No other taxation is payable.

## Summary

3.48 All the jurisdictions discussed above offer tax régimes that have advantages over the UK for a remote gambling operator seeking to compete in the global market. It might be argued that these are in the main jurisdictions with small local populations and with limited local skills and regulatory expertise. In our view it is important not to under-estimate the capacity of nascent pro-gambling jurisdictions to recruit expertise and provide incentives to spread it to the local population. The advantage that the UK may enjoy in terms of gambling and regulatory expertise may not be long-lived.

3.49 For convenience Table 1 briefly summarises the licence fees, gambling taxes and corporate taxes in place in the main competing jurisdictions described above.

**Table 1: Summary of gambling licence fees and taxation in alternative locations**

Location	Licence Fee (£ p.a.)*	Gambling tax	Corporate tax rate
Malta	4,800	0.5% of turnover capped at c. £320,000 p.a.	4.17% effective
Isle of Man	100 – 25,000 <sup>b</sup> 35,000 <sup>g</sup>	1.5% or 10% or 15% of gross win depending on origination of the bet	Zero
Alderney	75,000	None	Max. 20%, zero by 2008
Gibraltar	2,000	1% of turnover/gaming yield, min. £85,000, max. £425,000	Zero if granted exempt status
Antigua	39,800 <sup>g</sup> , 26,600 <sup>b</sup>	3% of gross handle	Zero
Curaçao	35,400	None	Max 2%
Kahnawake	4,300	None	Zero

<sup>b</sup>betting <sup>g</sup>Gaming \*Local currencies converted into sterling using the exchange rates quoted by [www.xe.com](http://www.xe.com) on 5 January 2005.

<sup>22</sup> <http://www.kahnawake.com/gamingcommission/forms/kgcregs.pdf>

## **4 TAX OPTIONS AND EFFECTS**

- 4.1 This section assesses different taxation options the government might consider for the remote gambling sector.
- 4.2 It seems to us that there are two main questions:
- how to tax the remote gaming sector in the UK in such a way as (a) to attract new operators and (b) to encourage UK operators whose remote gaming has had to be established offshore to re-establish it in the UK
  - how to tax the remote betting sector in order to retain it in the UK and to attract new operators.
- 4.3 Consequent issues then arise of how to achieve consistency as between betting and gaming and as between remote and non-remote.

### **Principles for the taxation of e-commerce**

- 4.4 Commonly adopted criteria for assessing any particular form or level of taxation have been neutrality, certainty, transparency effectiveness and efficiency.
- 4.5 Government has set out how these principles should apply particularly to the taxation of e-commerce, of which remote gambling forms an ever-increasing part. 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 *Electronic Commerce: the UK's Taxation Agenda* (Inland Revenue and HM Customs & Excise, 1999, [www.inlandrevenue.gov.uk](http://www.inlandrevenue.gov.uk)) and *e-commerce@its.best.uk* (Cabinet Office, 1999, [www.cabinet-office.gov.uk](http://www.cabinet-office.gov.uk)). Specifically:
- (a) *Neutrality* – the taxation of e-commerce should seek to be technology-neutral so that no particular form of commerce is advantaged or disadvantaged;
  - (b) *Certainty and transparency* – the rules for the taxation of e-commerce should be clear and simple so that businesses can anticipate, as far as possible, the tax consequences of the transactions they enter into;
  - (c) *Effectiveness* - the tax rules should not result in either double or unintentional taxation, and risks from evasion and avoidance should be kept to a minimum. The overriding aim should be that the right amount of tax is paid at the right time and in the right country; and
  - (d) *Efficiency* - the tax rules should be efficient, keeping the compliance costs of business and the administration costs of government to the minimum compatible with effective tax administration. Measures to counter evasion or avoidance should be proportionate to the risks which they seek to address.

- 4.6 In relation to the modernisation of gambling taxation, a further Customs consultation paper added the need for a fair basis for UK bookmakers to compete internationally and the need for a fair contribution from the gambling industry generally towards tax revenue.
- 4.7 Providing a fair basis for international competition is a distinct criterion in its own right – a different form of neutrality from neutrality between technical methods of remote gambling. We have therefore adopted it as an additional criterion in the assessment below. It is important because the positive reputation of UK operators, and the restrictions on gambling activity in other jurisdictions, combine to make the UK potentially a focal point for international remote gambling – provided the fiscal environment is right.
- 4.8 The question of a fair contribution towards general tax revenues is material both to the *form* of taxation and the *rate* at which the tax is set. The revenue available will also depend on the behavioural responses of the operators and of those who gamble. In considering the revenue available, it is appropriate to take into account not only contributions from tax applied directly to gambling, but other taxes too, such as corporation tax and personal income tax.
- 4.9 We do not believe that much hangs on perceived fairness (by operators, if taxation falls entirely on them) as between remote and non-remote gambling. At most, remote and non-remote gambling are in our view complements, not substitutes.
- 4.10 Perceived fairness by consumers, however, could become a hot topic if tax were proposed on gamblers themselves. We do not consider any form of tax on gamblers in this paper.

#### **Possible tax bases**

- 4.11 Although a number of different forms of gambling tax currently exist in the UK, Gross Profits Tax (GPT) now forms the basic tax technique for betting, pools and bingo. As our separate report for the ABB confirms, the substitution of GPT for General Betting Duty, which involves placing the tax burden on operators rather than on punters, has proved hugely successful.
- 4.12 If this option were adopted for remote gambling operators domiciled in the UK, they would be required to account for duty as a percentage of all gross profit derived from all gambling activity, just as bookmakers do currently.
- 4.13 A place of consumption tax (POCT) has been mentioned to us as one of the alternatives under consideration by Treasury officials for remote gambling. It was considered (but rejected) as an alternative to GPT during the betting tax reforms of 2001.
- 4.14 Under this option, tax at a rate yet to be determined would be payable on the stakes or winnings of customers located in the UK, no matter where the gambling operator they were dealing with might be located. Thus an overseas operator receiving money from, or paying money to, customers located in the UK would be required to appoint a tax

representative in the UK who would then be liable if the operator failed to meet its obligations.

4.15 We now assess GPT and POCT in turn.

## **Gross Profits Tax**

### *Providing a fair basis to compete internationally*

4.16 Set at a reasonable rate – a very big proviso – GPT could provide a fair basis for the UK remote gambling industry to compete internationally. It could enable operators both to develop the UK market and also to encourage overseas gamblers to transact with UK-based operators. It would be an attractive option to government, since gambling originating with overseas customers would contribute to UK tax revenues.

4.17 The extent to which GPT provides a fair basis to compete in international markets would depend on the rate at which the tax was levied. A rate of GPT at or close to zero would be necessary for UK operators to compete on a wholly fair basis with their overseas counterparts. While the tax might not be visible to the customer, it would affect the terms of competition between the operators: the lower the rate, the stronger the competitive position, and the easier it would be for UK operators to compete with overseas operators. Analysis of the rate should also take into account of the other tax burdens that operators based in the UK face.

### *Neutrality*

4.18 A uniform GPT rate would be neutral between ways of remote gambling and would therefore not in itself obstruct or distort the development of the markets or products. However, it would fail under other criteria.

### *Certainty and transparency*

4.19 GPT provides a coherent response to the problems of other means of taxing e-commerce, in that UK-based bookmakers would be taxed on gross profit from all their activities, wherever and however they organise them. The amount of duty a UK operator would be required to pay would in principle be clear once a return was compiled.

### *Effectiveness*

4.20 The effectiveness of GPT would depend on the extent to which UK companies could successfully compete in UK and international markets against competitors subject to low betting duties and low corporate taxes more generally. Doubts over the effectiveness of this tax therefore hinge on its rate: a significantly higher rate of UK tax relative to competitor jurisdictions would (a) deter internationally mobile operators from even setting foot in the UK, and (b) would affect the prices UK operators can offer, and the resources

available for marketing and promotional activities. UK operators would lose their share of the UK market and would be handicapped in seeking business overseas.

- 4.21 There seems little reason why tax evasion under GPT would be any higher than under other models. Indeed, a low GPT rate seems likely to reduce any incentive for operators to evade it.

#### *GPT rate*

- 4.22 We are aware that RGA has argued for a maximum 2 per cent GPT rate to be applied to UK-based operators of remote gambling, i.e. for betting and gaming alike. Compared with the 15 per cent rate applied to non-remote betting, 2 per cent might look low. But compared with other jurisdictions offering a zero rate or capped fixed sums, it is not attractive, let alone beguiling, to new operators who have yet to make a choice of location.
- 4.23 The problem is compounded by the UK rate of corporation tax, which is charged at 30 per cent of profits in excess of £1.5 million, and, where relevant, by VAT. It tends to be true that gambling operators subject to GPT for a large part of their operations are unable to recover very much of their input VAT.
- 4.24 We calculate that a remote gaming operator with a handle of £500 million, a gross gaming yield of £50 million and a liability to corporation tax of £25 million (all hypothetical numbers) would suffer total taxation ranging from under £100,000 p.a. to about £1.3 million in all but one of the overseas jurisdictions described in section 3 of this report. If the current UK tax régime were applied, we calculate that a UK-based operator would pay at least £18 million, and possibly more depending in his input and output VAT. We acknowledge entirely that the UK may be able to attract a “tax premium” which recognises its good reputation for integrity in the gambling field, and it is a matter of judgment how much that premium might be. In our view a hypothetical £18 million compared with a hypothetical £1.3 million is not a small premium. And, as we have said, other jurisdictions are highly likely to catch the UK up in respect of regulatory skill and integrity.
- 4.25 One cannot ignore the possibility that, in order to benefit from the UK *cachet*, some operators may seek a UK licence without transacting any material business here.
- 4.26 Our conclusion is that, if it wants to attract new substantial operators to locate their remote gambling operations in the UK, Government will have to offer a realistic rate of GPT (the 2 per cent suggested by RGA is in our judgment a maximum). As this report demonstrates, 2 per cent GPT is by international standards high but it could encourage some companies to relocate to the UK. The lower the rate below 2% the more attractive the UK would become. An alternative way of reducing the companies’ overall tax burdens would be the introduction of a special low rate of corporation tax or VAT, but we acknowledge that this may be objectionable to companies that pay the full rate.

- 4.27 In effect we take the view that Government would be unwise to count on much tax revenue from new remote gambling operators, even when, as from 2007, remote gaming is allowed in the UK. If the UK sets or leaves in place a high rate of overall taxation, few if any new operators will set up shop here. If it sets a low remote gaming tax rate – by which we mean close to zero – operators may come but the revenues from that specific source could be small.
- 4.28 There would, however, be associated benefits:
- the protection of existing jobs and the creation of new ones;
  - revenue increases from associated tax revenues; and
  - the important social policy gain of providing greater protection to gamblers that UK regulation is designed to provide. This is, after all, one of the main motivations behind the Gambling Act 2005, and Government continue to emphasise this point.
- 4.29 There remains the question whether UK-based operators, most of whom have remote gaming operations overseas, will bring them back to the UK after 2007; or conversely whether they might choose to move their UK-based remote betting operations offshore.
- 4.30 Our discussions with remote gambling operators lead us to believe that there are some attractions for them to repatriate their offshore gaming operations. There are management attractions, and relatively small costs, involved in locating scattered activities under one jurisdiction. It would be wise, however, not to over-estimate these benefits.
- 4.31 A far more important issue concerning tax revenue is whether these same companies would leave their remote betting operations in the UK or move them offshore.
- 4.32 The evidence we have heard from some operators is that their decisions will be based not on the treatment of remote betting in isolation but on Government decisions that affect their overall businesses. Bookmakers, for instance, feel strongly that there is in place an agreement with Government, under which remote betting remains on-shore in return for the change from general betting duty to betting gross profits tax; and they feel that any new material tax burden placed upon their betting operations, whether remote or non-remote, will breach that understanding. In those circumstances they may remove their remote betting operations off-shore.
- 4.33 Our estimate is that about 20 per cent of UK bookmakers' gross win is accounted for by remote betting (it is difficult to be precise because the figures are confidential to each bookmaker, and not all bookmakers account for remote betting in the same way). If this

20 per cent is even approximately right, then it follows that some 20 per cent of GPT revenue would be lost to the UK. Allowing for the proportion of total GPT accounted for by betting exchanges, we estimate that the 20 per cent represented by remote betting is worth about £80 million p.a.<sup>23</sup>

- 4.34 At present, remote betting is divided roughly 60/40 as between internet and telephone at the gross win level (with interactive TV accounting for a negligible percentage). It would be easy to remove internet-based betting. Because UK punters have become used to dealing with trained, well informed telephone operators, familiar with UK betting jargon a telephone-based operation might be more difficult to replicate overseas, but it would only be a matter of time.<sup>24</sup>
- 4.35 So, on current numbers and even in the short term, some £42 million of GPT would be at risk, and, in the longer term, the remaining £28 million.
- 4.36 Future revenues foregone would be even higher because remote betting is increasing faster than non-remote. For some operators the net margins on internet betting are higher than on telephone betting because of the higher staff costs associated with telephone call centres.
- 4.37 Even if telephone betting is not growing as fast as internet-based betting, its removal would have material employment implications. The thousands of staff employed in this part of the industry are not spread evenly around the country and the potential loss of employment could hit a handful of areas very badly.<sup>25</sup>

*A backlash from other operators?*

- 4.38 If Government is prepared to consider a very low UK tax regime for remote gambling, the question arises whether other operators would object on grounds of non-comparability. So far as bookmaking is concerned, we envisage no objections. A substantial proportion of bookmakers have remote gaming and betting activities, and the evidence we have heard from them suggests strongly that they would recognise a difference as necessary and unavoidable if Government wishes to attract or retain remote gambling in the UK.
- 4.39 We also believe that objections would be unlikely from the National Lottery operator. Its supply-side economics are fundamentally different from those of bricks-and-mortar bookmakers and from remote gambling operators. Other research we have carried out (a

<sup>23</sup> Assuming that GPT revenue is running at about £400 million p.a. and that the exchanges account for about £50 million.

<sup>24</sup> "A monkey on Stenhousemuir to draw two-all with Hibs on Boxing Day" would probably not be understood on day 1 in Curaçao. We understand the Hong Kong Jockey Club has successfully imposed a strict, jargon-free routine on callers.

<sup>25</sup> For example, bet365 employs 600 people in Stoke-on-Trent, making it one of the largest employers in that area.

2004 report on FOBTs for ABB and DCMS) indicate that its customer base is also far larger and more diverse than for any other form of UK gambling.

4.40 We have not considered the possible reactions of other gambling operators.

## **Place of consumption tax**

### *Defining the tax base*

- 4.41 One of the main challenges with POCT is to define the tax base – i.e. what is considered the place where the consumption occurs. One possibility, considered in government's earlier consultation leading to the GPT introduction, is to refer to the physical location of the customer as the place of consumption. An alternative view, put forward by the OECD during the same discussions, was that for services provided to private consumers and non-business organisations, the place of consumption should be defined as the usual place of residence (UPR). This, it was thought, would simplify decision-making for operators.
- 4.42 But POC seems to us an unworkable basis of taxation for remote gambling. It is in the very nature of the remote gambling that it can be located anywhere, and that the customers can connect to the services from anywhere. Tracing connections to physical locations would clearly be prohibitively expensive. Every transaction in the millions that take place each day would have to be tested for at least one, and possibly several, locations.
- 4.43 UPR might be marginally preferable, but the requirement to test all transactions against a list of jurisdictions appears to be no less onerous than testing for POC.
- 4.44 A further consideration specific to remote gaming is that in peer-to-peer gaming, such as poker, customers wager against each other instead of against the house. In poker, operators take their money (rake) from what is in the pot wagered by all players. As the pot reaches different levels, the rake increases. The same virtual poker table could have customers aggregated from several different service providers playing at the same time.<sup>26</sup> Computing how much of the rake relates to which player is very difficult, if not impossible, to do. This alone might render POCT ineffective.
- 4.45 One must also remember that, if gambling is to remain tax-free to customers, the effort required to identify individual gamblers' locations would serve only to add to the operator's own tax liability. It is hard to see why operators would willingly go along with such a process.

- 4.46 Finally, POCT also implies a measure of agreement between multiple governments. If the UK Government wishes to tax overseas operators on the activities of UK-based gamblers (however defined) it would presumably be necessary for it to negotiate a tax arrangement with other governments. In cases where the other government is using low-tax or no-tax arrangements to attract operators it is hard to see why it would agree to such a process either.
- 4.47 Insurance Premium Tax (IPT) has been sometimes considered an example of a successful POCT. Under IPT, applicants seeking insurance must specify the precise location of the risk when they purchase the service. Location of risk is well-defined in EU legislation. Even so, certain kinds of insurance for which the location of the risk cannot be readily defined and assured (e.g. international transport and freight) have been exempted from IPT on those very grounds. The IPT precedent is therefore be of limited relevance to remote gambling.
- 4.48 Most importantly, whereas IPT involves a relatively limited number of transactions between (in each case) two relatively large, visible corporate entities, remote gambling involves millions of transactions per day between private individuals and a very large number of suppliers.
- 4.49 The Isle of Man distinguishes between bets (not gaming stakes) originating from (a) the UK (b) in the Isle of Man and (c) elsewhere. It applies tax of 15 per cent, 10 per cent and zero per cent respectively to gross win. In this respect the Isle of Man does apply a POCT, but we doubt that in doing so it provides a model for the UK to adopt more widely. It applies, by negotiation with the UK government, a UK GPT rate to UK-originated bets as a *quid pro quo* for allowing Isle of Man operators to advertise in the UK. Given the physical location of the Isle of Man and its extensive trading connections with the UK, it is unsurprising that its Parliament should have chosen to do this, but our view remains that the relatively low rate of transactions involved does not make the Isle of Man's practice a model for more widespread applications.

*A fair basis for the UK betting industry to compete internationally?*

- 4.50 If POCT were imposed it seems likely that UK operators would face unfair competition from international operators supplying to UK customers and evading the tax.

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<sup>26</sup> Pooling customers into the same tables by different customer service providers is an essential part of the business model – it guarantees that each customer will always have the kind of table available that he/she wants.

- 4.51 If POCT were implemented as a tax on betting turnover (as was discussed in 2001) it would inhibit UK operators from developing the high-volume, low-margin markets which have proved to be so effective in UK betting. The competitive position of UK operators in international markets would thus be weakened by the detrimental effect the tax would have on domestic profitability.
- 4.52 A POCT operated by the UK alone could create problems of double taxation. For example what would happen in the case of, say, an Irish operator selling services to UK customers – would they be subject to Irish or UK tax, or both? If both, the overseas operator would hardly wish to appoint a UK tax representative. A UK POCT would not in our view be sustainable unless other countries could be persuaded to bring their tax régimes into line – surely a heroic assumption?
- 4.53 All in all, the idea of applying POCT to remote gambling seems to us so unworkable as not to warrant examination under the criteria set out above.

## **5 IN CONCLUSION...**

- 5.1 Remote gambling is the fastest growing sector of the world gambling market. It is international and intensely competitive. Any tax treatment of the sector must take account of that wider context, not solely what happens within the UK.
- 5.2 Government's repeatedly stated aim is to bring the remote gambling industry to the UK, where it can provide a safe, well regulated alternative for UK and other citizens, consistently with the provisions of the new Gambling Act.
- 5.3 Responsible remote gambling operators are not deterred by the additional cost of *regulation* associated with the UK and we have heard that some are indeed willing to relocate here. But they are commercial enterprises and it must be *economically* viable for them to do so. Government can benefit socially and in terms of revenue from repatriation, but it will require remote gambling in general and remote gaming in particular to be considered objectively on merit, and especially in the context of competitive pressures from other jurisdictions.
- 5.4 If the Government fails to strike a perceived fair balance then remote operators, especially those based elsewhere in other EU members states (Gibraltar or Malta), will continue to thrive, grow and attract custom away from the UK.
- 5.5 If, on the other hand, Government can accommodate the needs of remote gambling the UK can share in the benefits associated with a success. The Exchequer currently receives no revenue from remote gaming, so a GPT of 2 per cent or less, while low compared to other domestic gambling tax rates, would still produce a new stream of income.

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