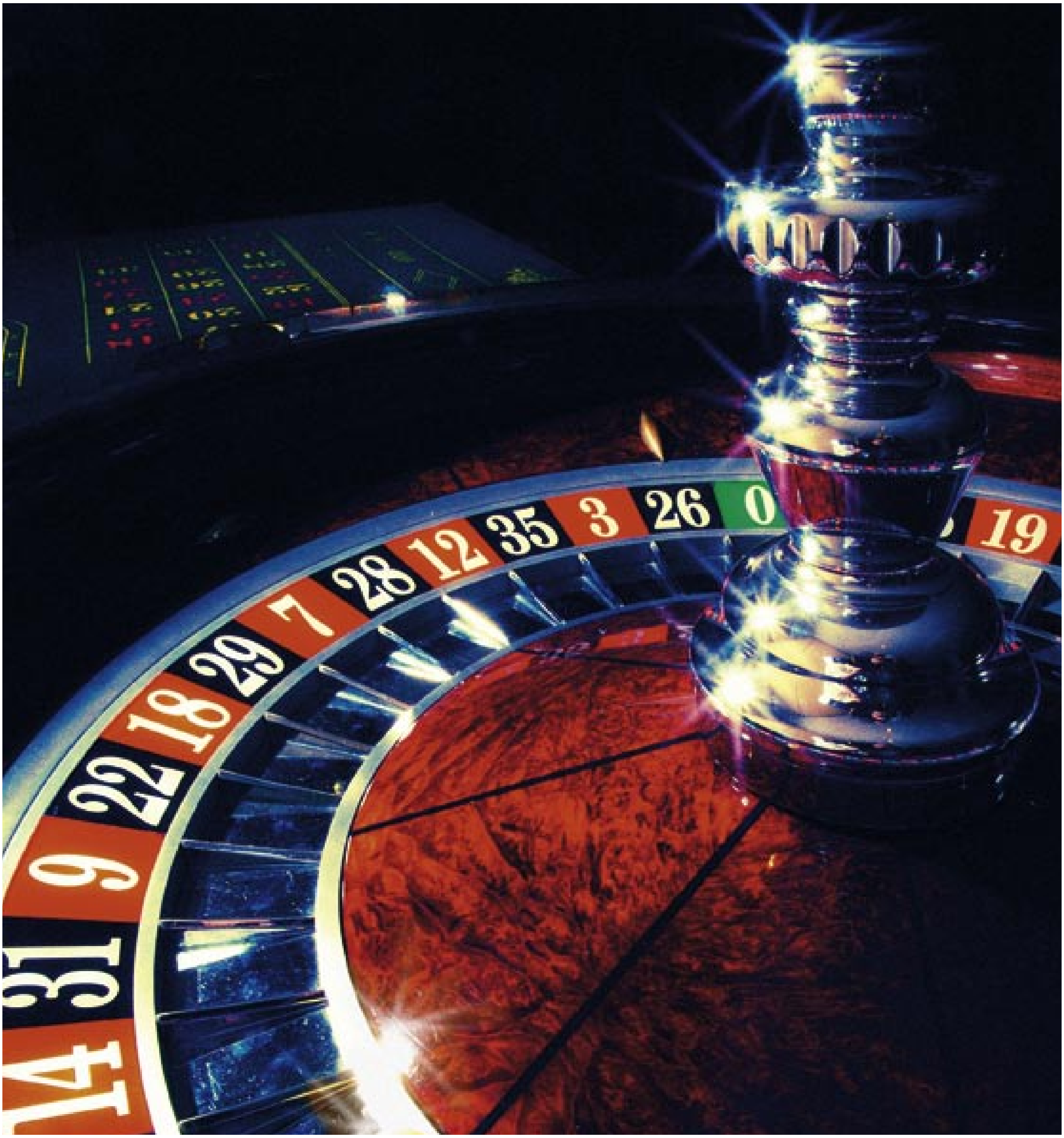

NATIONAL AUDIT OFFICE

HM CUSTOMS AND EXCISE

Gambling Duties

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 188 Session 2004-2005 | 14 January 2005

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Gambling Duties

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John Bourn
Comptroller and Auditor General
National Audit Office

20 December 2004

The National Audit Office study team consisted of:

Nick Lacy, Toby Evans and Angela Silberberg under the direction of Jane Wheeler

This report can be found on the National Audit Office web site at www.nao.org.uk

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Email: enquiries@nao.gsi.gov.uk

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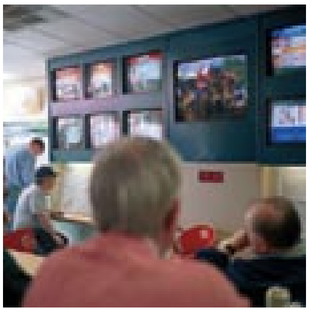


PART 3

APPENDICES

EXECUTIVE SUMMARY

1 There are six types of gambling duties: lottery, general betting, bingo, gaming, pools betting, and amusement machines licence. The estimated annual turnover on gambling activities in the UK is about £53 billion and in 2003–04 HM Customs and Excise collected £1.35[1] billion in gambling duties.

2 Our report on 'Revenue from Gambling Duties'[2] in March 2000 examined Customs' analysis and management of risks to revenue and how resources were used. The main risks identified at that time were losses of revenue from illegal betting of around £25 million to £100 million per year, and new forms of gambling on the Internet and by telephone. The Committee of Public Accounts recommended in November 2000[3] that Customs should address the losses of revenue through planned reforms of betting duty and keep the level of coverage of individual gambling duties under review to ensure that individual duties were adequately protected. The Committee also recommended that Customs should develop closer working relationships with other public sector bodies such as the Gaming Board, local authorities, the police and the Inland Revenue.

3 This report examines Customs' progress on these recommendations in the light of the main developments in the gambling industry since 2000, specifically:

- **The protection of gambling duty revenues (Part 1);**
- **The use of resources to target risks to gambling duties (Part 2); and**
- **Customs' response to the changes in the gambling industry (Part 3).**

The National Audit Office study methodology is set out in Appendix 2.

Our main findings are:

Customs' progress on the Committee of Public Accounts' recommendations

4 **Customs has implemented most of the recommendations made by the Committee of Public Accounts and has work in progress on the remainder.** It has recovered arrears of amusement machine licence duty and has introduced a Gross Profits Tax for general betting to secure duty revenue by encouraging bookmakers to locate their telephone and Internet betting operations in the UK. It has developed a closer working relationship with other public sector bodies such as the Gaming Board and refined its risk assessment to target its resources and maintain coverage of individual gambling duty streams. It has developed a methodology to measure the tax gap on general betting duty. It now plans to conduct a series of surveys to obtain an independent estimate of net spending on this type of gambling which is needed to calculate the tax gap.

5 By implementing the recommendations of the Committee of Public Accounts and National Audit Office reports in 2000 and taking further action to recover revenue Customs has secured additional revenue of some £10 million. This includes £4.1 million from using statutory powers to recover revenue from arrears of amusement machine license duty between 2001 and 2004, £4.5 million from better analysis of trader records held on the central accounting system to identify missing returns from traders and an additional £0.7 million by identifying traders with non-consecutive licences and unregistered operators. Continuing exercises to target these risks and better management of assurance work to secure additional revenue from traders could secure at least £1 million more. Implementing the further recommendations in this report should help to reduce losses from revenue by better targeting of resources and tackling new areas of risk.

1 HM Customs and Excise.
2 National Audit Office, Revenue from Gambling Duties, HC 352 Session 1999–2000, March 2000.
3 Committee of Public Accounts Report, HC 423 Session 1999–00, November 2000.

Protection of gambling duty revenues

6 Customs reformed betting duty in October 2001, by introducing a Gross Profits Tax to tax bookmaker profits instead of bets. This has reversed the trend of bookmakers moving their telephone and Internet operations offshore which was increasingly threatening gambling duty revenue. The initial fall in revenue from general betting duty, from £487 million in 2000–01 to £383 million in 2003–04, was in line with Customs' estimates when making the change and it is likely that the reduction under the old regime would have been higher in the longer term had no change been made. Customs considered that betting duty revenue should be back to where pre-Gross Profit Tax levels would have been within two to five years, but this depends on the growth in betting turnover. Betting duty as a percentage of the total amount staked has fallen from 6.7 per cent in 1999–00 to 1.2 per cent in 2003–04, partly as a result of low profit and duty margin on Fixed Odds Betting Terminals.

7 Gambling duty revenue has been falling in recent years, due to the initial decline from general betting duty after the introduction of Gross Profits Tax and lower spending on the National Lottery. In 2003–04 Customs collected £1.35 billion in gambling duties compared to £1.53 billion in 1998–99, representing a fall as a percentage of all indirect taxes and duties from 1.6 per cent to 1.2 per cent[4] over the same period. The introduction of Gross Profits Tax for bingo and pools betting has also resulted in a reduction in revenue. Gross Profits Tax was extended to pools betting duty in April 2002 and to bingo duty in October 2003 to bring them into line with general betting duty. Pools betting duty fell by half after the introduction of Gross Profits Tax from £26 million in 2001–02 to £13 million in 2003–04. A consultation exercise for introducing Gross Profits Tax for amusement machine licence duty ended in October 2003, and the Government has decided to defer any further major reforms to gambling duties until after enactment of the Gambling Bill.[5] The decrease in duty take from amusement machines is due to the decrease in the number of machines and the increase in the popularity of Fixed Odds Betting Terminals.

Use of resources to target risks to gambling duties

8 Customs has reduced resources allocated to gambling duties from 41 staff-years in 1999–2000 to 26 staff-years in 2003–04. It has refined its approach to risk assessment and set up a small dedicated team to cover the 11 largest traders in the betting and gaming industry.[6] In 2000 the Committee of Public Accounts was concerned that ongoing changes by Customs in the allocation of resources across excise duties and VAT might reduce the coverage of gambling duties, with consequential loss of revenue. The Large Business Group team in carrying out compliance management activities on the largest traders has so far focused on a better understanding of the industry and identifying potential areas of risk.

9 Customs has centralised all information on traders in 2004 to improve risk assessment and set up teams to identify high-risk traders and to improve the consistency and feedback of the results of work. Customs has developed a risk model to target its work more efficiently on high-risk bookmakers. Customs' risk assessment for the 1,190 small- and medium-sized bookmakers (which contribute around a quarter of general betting duty) has been hampered by the lack of regular and structured feedback of the results of its work, as well as regional variations in the work. Since April 2004, Customs has centralised its resources and is implementing new processes to address this problem.

10 Since 2000 some of the risks to gambling duties have changed. Some traditional areas of risk to revenue, such as operators using amusement machines without licences are being tackled by Customs who are starting to quantify and assess the potential duty at risk from others such as betting exchanges and spread betting. Customs has used statutory powers introduced in 2000 to recover arrears of amusement machine licence duty. The introduction of Gross Profits Tax has significantly reduced the incentive for illegal betting as bets are now tax free. Although Customs does not have any up-to-date-estimates of potential loss of revenue, the changeover to Gross Profits Tax has significantly decreased the duty at risk from illegal betting. The introduction of the Gross Profits Tax

4 Audited figures for 2003–04.
5 HM Treasury, *Budget 2004*, p.124.
6 Duty from the 11 largest traders represents over 75 per cent of all betting duties.

regime may also have increased the risk that operators artificially suppress bets to reduce the amounts liable to duty-take. The duty returns for betting exchanges do not include the commission rate and do not therefore reflect the relationship between commission and duty. Customs is working with the industry to devise an appropriate return. For betting exchanges there is a risk that traders manipulate commission on which the duty is based and there is also the risk of money laundering activities. Customs does not have any estimate of the likely losses from these risks.

11 Customs' exercises to identify missing bookmaker returns and improve trader compliance in getting duty in on time and chasing outstanding debts have yielded over £12 million of additional revenue since 2001. Customs could make more use of penalties to encourage traders to comply. Customs uses several approaches to target areas of risk including visits to traders which identified an additional revenue yield of nearly £2 million in 2002–03 but only £0.7 million in 2003–04. This might reflect improved trader compliance or the emphasis placed in risk assessments on collecting additional revenue. It could also be a consequence of the reduction of the effective rate of tax after the introduction of Gross Profits Tax. In 2001 Customs identified £4.5 million additional revenue from missing returns from bookmakers. It has also recovered £4.1 million in arrears of amusement machine licence duty between 2001 and 2004. It has reduced the debt outstanding from bookmakers and bingo operators from £3.5 million in March 2003 to £2.3 million a year later. Customs' action has reduced the live debt to less than £1 million and around £1.5 million from de-registered traders. Traders submitted around 1,200 late returns and payments in 2003–04. Customs has issued warning letters and over 200 penalties for non-compliance, although over half had not been paid by October 2004.

12 To make effective use of its resources Customs takes advantage of the Gaming Board's monitoring of casinos and bingo operators' activities. This enables Customs to reduce its coverage of these duty streams, which it considers to be low risk. The Committee of Public Accounts' reports on *Revenue from Gambling Duties*[7] and *The Gaming Board: Better Regulation*[8] recommended that Customs could benefit from a closer working relationship and greater exchange of information with external stakeholders, in particular the Gaming Board. Customs signed a Memorandum of Understanding with the Gaming Board in 2000 (updated in 2004), to improve their working relationship at national and local level. Together they have carried out a number of joint exercises targeted mainly at amusement machine operators. Customs' work with the Inland Revenue on gambling duties has been mainly focused on large businesses with exchange of risk information. The establishment of the new HM Revenue and Customs Department and the proposed new Gambling Commission provides opportunities for better information sharing on risks and pooling of expertise.

Response to the changes in the gambling industry

13 New forms of gambling activity since 2000 pose risks to revenue. The industry has used technology to develop new gambling methods and products such as betting exchanges. Customs will require sufficient expertise to undertake compliance work on these activities. Staff do not have the IT expertise to interrogate complex computer-based gambling systems, but can access the specialist skills of Customs' Computer Audit Service. Betting exchanges pose new risks, because of the way they pay duty on commission. Customs has used IT expertise to: interrogate betting exchanges; develop a better understanding of the market; the main operators and of how commission is calculated by betting exchanges; how the Internet functions; and methods in pinpointing operators. The Chancellor announced in Budget 2004 that further work would be done to settle a fair and equitable tax treatment for betting exchanges.[9] Customs intends to carry out research into spread betting in order to quantify the risk to revenue.

7 Committee of Public Accounts Report, HC 423 Session 1999-2000.
8 Committee of Public Accounts Report, HC 611 Session 1999-2000.
9 HM Treasury, Budget 2004.

14 The Gambling Bill provides for the creation of a new Gambling Commission with wider powers than the existing Gaming Board to regulate the gambling industry. Customs will need to analyse the likely impact of the proposed changes in the Bill on duty revenue and the audit of the gambling duty streams, including the need for both further gambling duty reform and close working with the proposed Gambling Commission. The Gambling Bill is likely to increase betting and gaming duty revenue, particularly revenue from casinos and amusement machines.

Conclusions

15 Customs has implemented most of the recommendations of the Committee of Public Accounts' report on gambling duties of 2000. Work by Customs on measuring the tax gap[10] is now due to be completed by 2006. Customs deferred this work to allow for changes arising from the Gross Profits Tax reform in 2001 to take effect. The introduction of Gross Profits Tax for betting duty in 2001 has reversed the trend in bookmakers moving their telephone and Internet betting operations overseas. While Customs' resources used on gambling duty work has nearly halved since 2000, it has made progress in developing its risk assessment for small- and medium-sized traders, setting up expert teams for large businesses and small- and medium-sized traders, and has had some success with one-off exercises which has yielded additional revenue by targeting losses from specific gambling duty regimes.

16 Customs' risk assessment and effective use of resources has been hampered by the lack of regular feedback of the results of its assurance activities. Customs has addressed this by centralising staff resources and records and by introducing a management assurance programme to ensure consistency of the quality and nature of information obtained. Although all the records are now retained in one location there remain weaknesses because the information is not kept in a form that lends itself to easy retrieval and analysis. Retrieval might be improved by the replacement of the present manual system with an electronic version. Customs staff use their discretion to consider what action will best improve future compliance. A central team in Greenock uses telephone contacts, education and sanctions including the imposition of penalties and objections to social permits to improve trader compliance. Customs could make more use of sanctions to encourage trader compliance.

17 Customs is starting to develop a better understanding of the risks posed by remote gambling to target its work accordingly and prevent revenue loss. On the basis of a wider analysis of risks across excise duty streams, Customs has allocated fewer staff resources to gambling duties. However, with the creation of the new Revenue and Customs Department, there is the opportunity to pool expertise and obtain a more comprehensive picture of traders' businesses, building on the approach used on large businesses. With the creation of the new Gambling Commission, it also has the opportunity to develop a joint strategy to target risks and pool expertise building on the existing information sharing between Customs and the Gaming Board.

10 The tax gap is the gap between the theoretical tax payable and the actual amount collected.

RECOMMENDATIONS

18 To implement the Committee's recommendations from 2000 in full, Customs should complete the work underway to establish an estimate of the tax gap for general betting duty by 2006. This should include in the first instance the potential loss of revenue from all betting activity, including Internet betting. It should be followed up by identification of tax gaps in other regimes such as amusement machines licence duty and gaming duty, including Internet gaming. This estimate is important to ensure that Customs' activities are directed at the main areas of existing and emerging revenue loss.

19 To make better use of information it obtains on traders to assess risks to revenue, target its resources and ensure trader compliance, Customs should strengthen the management of its assurance work on gambling duties including quality assurance of completed work. Customs has started to implement this recommendation. It now needs to monitor its management assurance programme to ensure ongoing improvement of its compliance activities are in accordance with its audit standards. It should set specific indicators to measure performance of the gambling duty operational teams linked to the identification of additional duty collected. Retrieval and analysis of data held by the Department could be improved by the replacement of the present manual system with an electronic version. As accessing departmental information is presently cumbersome and time consuming, Customs should assess the costs and potential benefits of introducing an electronic system for trader folders.

20 To encourage traders to comply with their duty return and payments obligations, Customs should review the use and scale of penalties for late returns. This needs to be taken forward in the context of the wider review of the new HM Revenue and Customs Department's penalty policy which is looking to establish a common set of penalty principles and a penalty framework. It should also investigate the use of electronically based technology to enable traders to submit their duty returns and licence applications online as part of the Customs' wider programme to enable online submission of tax returns and payments.

21 To enhance Customs' risk assessment and targeting of resources to reflect the growth in new forms of gambling business, Customs should further develop its risk assessment of gambling duties particularly for small and medium-sized businesses, for example by:

- improving feedback from actual assurance work, to understand better what is happening at grass roots level to develop its risk strategy;
- producing a risk log of all sources of error, fraud and avoidance measures used;
- undertaking a random sample audit of traders to detect any new areas of error and avoidance, to update the compliance strategy;
- using external research on the wider trends in gambling, particularly for electronic betting, to identify where losses may occur in the future; and
- continuing to examine the risks posed by spread betting and betting exchanges, by developing a better understanding of the industry, in particular the main operators and how different rates of commission affect duty revenue.

22 With the growing diversity of the gambling industry, Customs should work with other bodies, especially the proposed Gambling Commission, to share information, pool expertise and target activities on high-risk traders. In particular Customs should develop a joint strategy with the proposed Gambling Commission for pooling expertise, risk assessment, operational activities and information sharing, common targets, and exchange of staff. This should also draw on any assessment by other government departments of the potential risks posed from money laundering in the industry. With the creation of the new HM Revenue and Customs Department and the limited resources devoted to gambling duties, it should share information with assurance teams on VAT and direct taxes, for example on the audit of electronically based gambling and gaming activities. It should also examine the benefits of joining up the compliance work of the new Department on corporation tax and duties under the Gross Profits Tax regime in respect of incorporated companies.

PART ONE

Protection of gambling duty revenues

This part of the report examines Customs' response to the Committee of Public Accounts' recommendations and the steps it has taken to protect duty revenues. It shows that Customs has implemented in full half of the recommendations by the Committee of Public Accounts in its report on Gambling Duties in 2000, and has made progress on the rest. It also shows that the introduction of Gross Profits Tax for betting duty in 2001 has reversed the decline in duty from bookmakers moving their telephone and Internet betting operations overseas but for pools duty the revenue take has fallen by half.

1.1 HM Customs and Excise[11] is responsible for the assessment and collection of gambling duties from traders offering betting and gaming activities in the United Kingdom. Total duty revenue in 2003–04 amounted to £1.35 billion. Customs' objectives for gambling duties are to create an environment in which the betting and gaming industry can compete and grow, while ensuring that taxes operate in a way that is fair, efficient and sustainable.[12]

1.2 There are six types of gambling duties – lottery, general betting, amusement machines licence, bingo, gaming, and pools. Each duty has its own rate regime, based either on gross profit, stake, commission earned or usage. Lottery duty and general betting duty make up over two-thirds of the total **(Figure 1)**.

1 Gambling Duty Revenue and Rates in 2003–04

Duty	Duty Rate	Net revenue in 2003–04 (£m)	Percentage of total gambling duty revenues
Lottery Duty	12 per cent of gross stakes receipts	559	41.5
General Betting Duty[1]	15 per cent of net stakes receipts	383	28.4
Amusement Machine Licence Duty (AMLD)	5 rates based on category of machine	144	10.7
Gaming Duty	5 tax rates from 2.5 per cent to 40 percent depending on size of casino's gross profits	138	10.2
Bingo Duty	15 per cent of net stakes receipts	111	8.2
Pools Betting Duty	15 per cent of net stakes receipts	13	1.0
Total		1,347	100.0

Source: National Audit Office analysis of HM Customs and Excise statistics

NOTE

1 Spread betting and betting exchanges fall under the remit of General Betting Duty. Spread betting is taxed on net stakes receipts, at 3 per cent for financial bets and 10 per cent for sports bets, and betting exchanges are taxed at 15 per cent of commission receipts. More details on duty rates are given at Appendix 1.

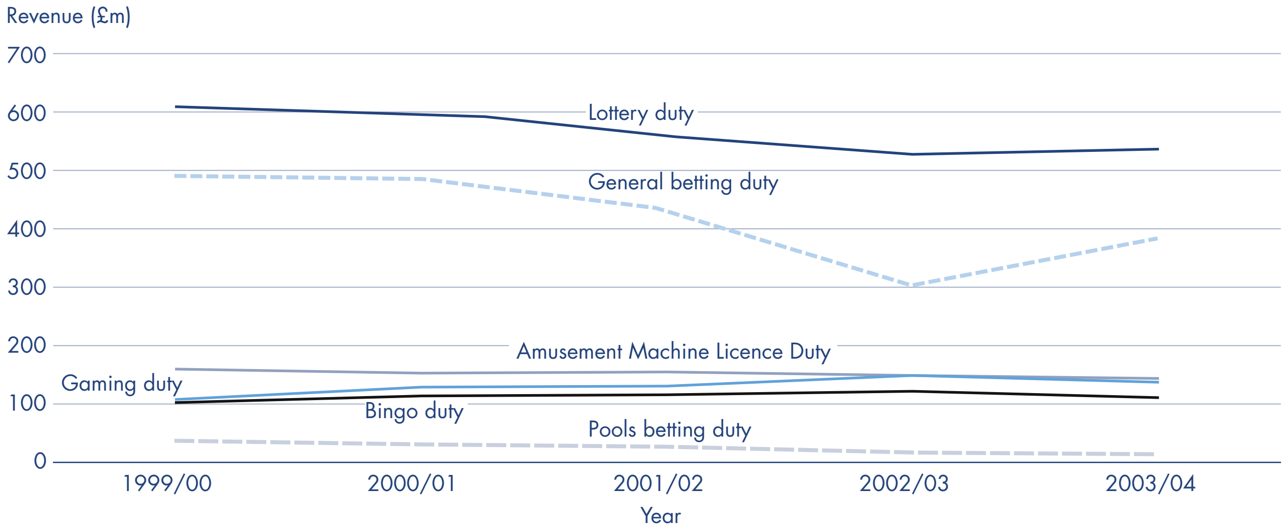
11 Alongside Budget 2004, the Government announced its intention to integrate Customs and Excise and Inland Revenue into a new department, HM Revenue and Customs, as a result of the recommendations in the O'Donnell Review.

12 HM Customs and Excise, *The Modernisation of Gambling Taxes: Consultation on the Review of Amusement Machine Licence Duty*, July 2003 p.3.

1.3 Duty revenue fell by 11.8 per cent, from £1.53 billion in 1998–99 to £1.35 billion in 2003–04, and as a percentage of all indirect taxes from 1.6 per cent to 1.2[13] per cent over the same period. There have been both increases and decreases in the individual duty streams **(Figure 2)**:

- **lottery duty** has fallen due to the decrease in national lottery sales;
- **general betting duty** decreased significantly after the introduction of Gross Profits Tax in October 2001 although it has recovered in 2003–04 due to the rise in betting turnover;
- **pools betting duty also decreased significantly after the introduction of Gross Profits Tax in April 2002;**
- **gaming duty** has increased by 50 per cent from £91 million in 1998–99 to £138 million in 2003–04;
- **bingo duty** has remained fairly constant at around £110 million; and
- **amusement machines licence duty** has decreased due to the decline in the number of machines subject to duty.

2 Duty revenues for gambling duties



	1998-99 £m	1999-00 £m	2000-01 £m	2001-02 £m	2002-03 £m	2003-04 £m
General betting duty	480	492	487	433	304	383
Pools Betting duty	70	38	30	26	16	13
Gaming duty	91	107	129	130	151	138
Amusement Machine Licence Duty	157	160	153	155	149	144
Bingo duty	105	107	114	116	122	111
Lottery duty	628	609	596	580	550	559
Total receipts from gambling duties	**1,531**	**1,513**	**1,509**	**1,440**	**1,292**	**1,347**
Gambling duties as per cent of total duties	**1.63%**	**1.55%**	**1.48%**	**1.37%**	**1.19%**	**1.16%**

Source: National Audit Office analysis of HM Customs and Excise statistics

13 Audited figure for 2003–04.

1.4 The gambling industry has expanded significantly since 1999–2000 and spending on gambling has increased. It is estimated that the total amount staked on all gambling in the United Kingdom has doubled from £27 billion in 1999–2000 to £53 billion in 2003–04 **(Figure 3)**. Stakes less winnings paid out to punters grew by 20 per cent from £6.90 billion in 1999–2000 to £8.28 billion in 2003–04[14]. The increase is due to higher spending on general betting since the introduction of Gross Profits Tax in 2001, as this change meant that punters could bet tax-free whereas previously they had a percentage of their stakes deducted by bookmakers to pay general betting duty **(see Figure 6)**.

Customs' administration of gambling duties

1.5 Several of Customs' divisions are involved in the administration of gambling duties **(Figure 4)**. The policy development division is responsible for setting duty rates and liaising with other departments, particularly the Department for Culture, Media and Sport. Excise Operations sets annual operational targets and provides guidance to Regional Business Services and the Large Business Group, but it does not direct work at local level. Policy Development and Excise Operations divisions are supported by Tax Practice division, which forecasts the effect of any changes in legislation on future duty take.

3 Gross Spending[1] on Gambling

	1999-00 (£m)	2000-01 (£m)	2001-02 (£m)	2002-03 (£m)	2003-04 (£m)
General betting	7,290	7,097	10,120	18,761	32,264
National Lottery	5,067	5,043	4,833	4,549	4,587
Pools betting	201	174	144	121	111
Casinos[2]	3,109	3,316	3,582	3,797	4,073
Bingo clubs	1,076	1,118	1,164	1,222	1,381
Amusement machines	10,452	10,517	10,743	10,839	11,000[3]
TOTAL	27,195	27,265	30,586	39,289	53,416

Source: For general betting, national lottery and pools betting: Customs and Excise Annual Report and Budget Report; for casinos and bingo clubs: The Gaming Board; for amusement machines: Henley Centre/BACTA

NOTES

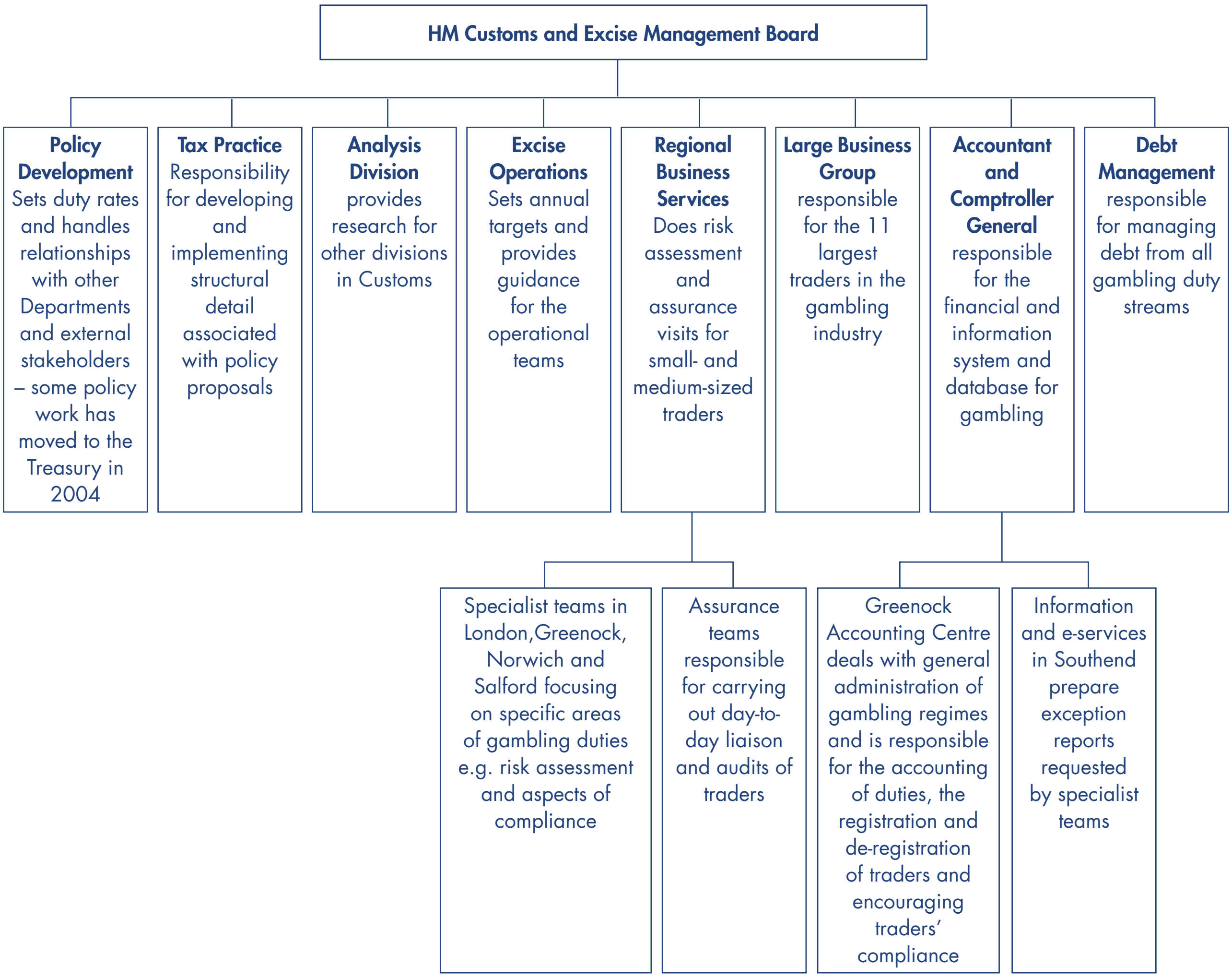
1 Gross Spending is amount staked by punters.

2 For casinos, expenditure is the total amount exchanged for chips.

3 Provisional figures.

14 Paton, D, Nottingham University, & Vaughan Williams, L, Nottingham Trent University, *Study of Gambling Duties*: A Report for the National Audit Office, June 2004.

4 Customs' organisational structure for gambling



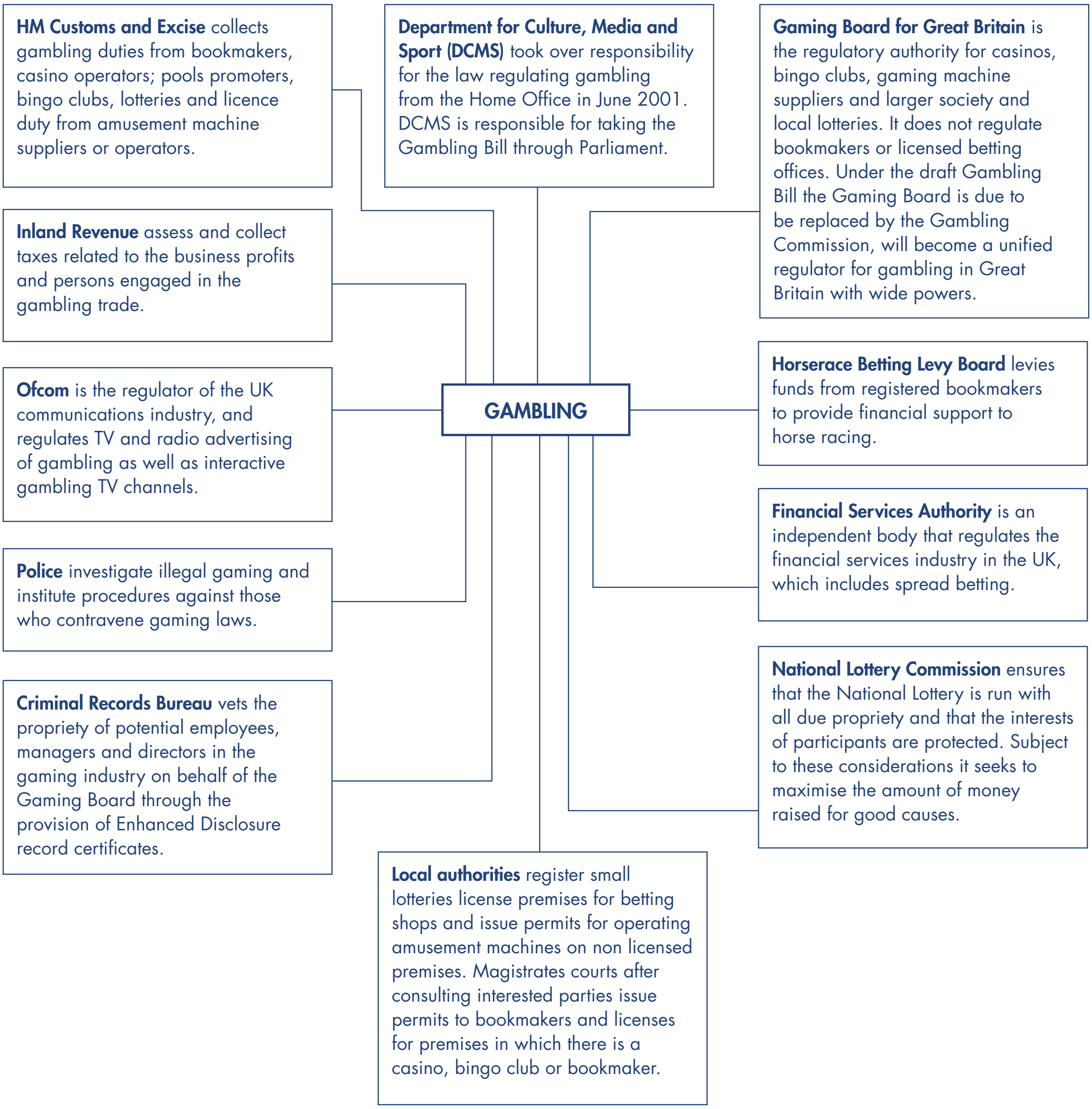
Source: National Audit Office

1.6 Analysis Division serves all excise duty and VAT regimes, and has developed a risk assessment model on bookmakers, and is developing a measurement of the tax gap for general betting. Customs' Accountant and Comptroller General handles duty collection. Debt Management serves all tax regimes including gambling duties. Each division retains autonomy of action, so it is important that they work together to avoid fragmentation of effort and lack of focus.

Responsibilities in Gambling

1.7 Working closely with other organisations is an important part of Customs' work on gambling duties. The Department for Culture, Media and Sport (DCMS) is responsible for the social legislation regulating gambling. A number of other public bodies have responsibility in the administration of gambling **(Figure 5)**.

5 Public Sector bodies involved in administering gambling



Source: National Audit Office

Previous coverage and implementation of Committee of Public Accounts' recommendations

1.8 We reported on 'Revenue from Gambling Duties'[15] in March 2000, and the report focused on Customs' analysis and management of risks to revenue and how its resources were used. In November 2000 the Committee of Public Accounts[16] made six main recommendations regarding Customs' work on gambling duties:

- reduce the loss of revenue from amusement machines licence duty (Customs' action on this recommendation is covered in paragraphs 2.22-2.23);
- complete research into the size of the tax gap caused by illegal betting (paragraph 1.8);
- address the revenue loss from increased internet and telephone betting (paragraphs 1.9-1.19);
- take the lead in working together with other public bodies (paragraph 2.24-2.26);
- keep the level of coverage of individual duties under review (paragraph 2.4-2.6); and
- improve the consistency of its work on traders across its operating regions (paragraphs 2.14 and 2.19).

Customs has implemented in full half of the recommendations, and has work in progress on the remainder **(Appendix 4)**. In summary:

On amusement machines – Following a recommendation in my report in 2000 that Customs should pursue amusement machine operators for arrears of duty during periods of illegal operation, new statutory powers to recover arrears of duty came into effect in July 2000. These powers enabled Customs to demand arrears of licence duty up to three years overdue. For the three years 2001 to 2003, Customs issued 5,116 retrospective demands totalling nearly £5.5 million of overdue revenue, which has resulted in actual revenue received of over £4.1 million.

On illegal betting – The introduction of Gross Profits Tax for bookmakers in October 2001 has resulted in a significant reduction in illegal bookmakers. The likely explanation is that since consumers can now place a bet tax-free there is no incentive for them to use an illegal bookmaker to avoid tax. Stakes with licensed bookmakers have increased significantly since the introduction of Gross Profits Tax. Work by Customs on measuring the tax gap[17] was due to be completed in 2001, but has been deferred with the introduction of Gross Profits Tax to 2006. Customs is concentrating on developing a tax gap analysis for general betting duty. It is funding a number of omnibus surveys to provide an independent estimate of net spending on dutiable betting. Customs' aim is that some detailed questions on gambling will be included in a future omnibus survey, conducted by the Office of National Statistics, to generate overall spending data.

On telephone and Internet betting – Customs recognised the threat to duty revenue from activities being displaced overseas and conducted a wide-ranging consultation exercise to identify the best way to reverse this trend and secure the tax base in the UK. This resulted in the introduction of the Gross Profits Tax for betting duty and a full assessment is included later in this Part.

On working more closely together with other public bodies involved in gambling administration – Our report on the Gaming Board[18] and the subsequent Committee of Public Accounts report[19] focused on how the Gaming Board regulates and supervises the gaming industry and registered lotteries. It recommended that the Board should develop better techniques for assessing risks and a close working relationship with Customs. Customs signed a Memorandum of Understanding with the Gaming Board in 2000, updated in November 2004, but has considered other Memoranda of Understanding unnecessary, as informal working relations with other public sector bodies such as local authorities and the police are strong at local level. There are examples of where joint working with local authorities and police has resulted in direct action to remove unlicensed gaming machines and in closing down illegal traders. Contacts with the Inland Revenue have been built up, especially within the Large Business Group, where regular meetings now take place. Customs' Regional Business Services has exchanged guidance on small- and medium-sized traders and is presently working on a joint operation concerning the underpayment of duty in the region of £2 million.

15 National Audit Office, *Revenue from Gambling Duties*, HC 352 Session 1999–2000, March 2000.
16 Committee of Public Accounts Report, HC 423 Session 1999–.2000, November 2000.
17 The tax gap is the gap between the theoretical tax payable and the actual amount collected.
18 National Audit Office, *The Gaming Board: Better Regulation*, HC 537 Session 1999–2000, June 2000.
19 *Committee of Public Accounts Report*, HC 611 Session 1999–2000.

On maintaining sufficient coverage of individual duty regimes (regime integrity) – Customs has refined its risk assessment and set targets for its work for each year since 2001–02. For example in 2003–04, 25 per cent of bookmakers, 10 per cent of casino and bingo traders, and all amusement machine suppliers and operators paying more than £50,000 in duty were targeted for a visit by Customs compliance officers.

On sufficient resources – In 1998–99 Customs allocated some 41 staff-years to gambling duties at a cost of £1.4 million. In 2000 the Department introduced a new business-assurance model across all excise duties based on risks to revenue. This has resulted in resources being transferred away from gambling duties to higher risk priorities. In 2003–04, Customs allocated 26 staff-years to the assurance of gambling duties. In 2003 the largest ten gambling traders were transferred from regional offices to the Large Business Group, which was allocated 1.33 staff-years to administer them. The resources are set to decrease again to 23 staff-years (not including Large Business Group) for 2004–05. It is important that Customs ensure there is sufficient coverage of individual duty regimes.

Protecting duty revenues – evaluation of Gross Profits Tax

1.9 Since 2000 there have been a number of developments in gambling duty regimes and regulatory arrangements **(Appendix 3)**. For gambling, the main objectives of Customs, in conjunction with other public bodies, are that the UK-based gambling industry should continue to thrive, that gambling should continue to make a fair and effective contribution to general tax revenues, and that the customer should get a fair deal.[20] In order to achieve these aims it is essential to keep as many businesses based in the UK as possible to secure the tax base.

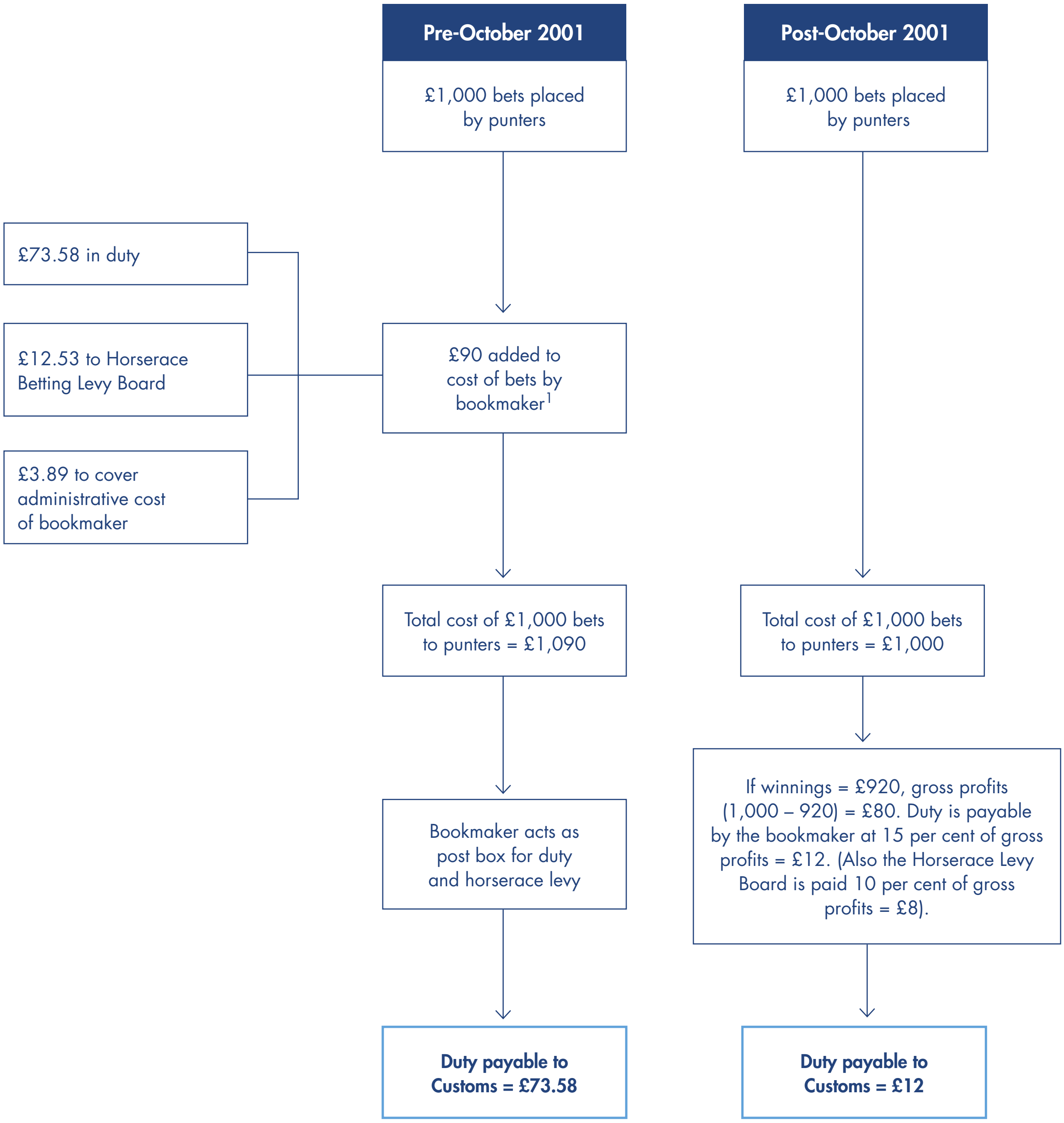
1.10 Changes in tax rates can influence whether businesses decide to base themselves in the UK or overseas. If the tax regime in the UK is stricter and levied at a higher rate than overseas, businesses might see this as an incentive to relocate offshore, while still offering services to UK punters. In which case companies will not be liable to tax in the UK and revenue will be lost. The advent of electronic gambling means betting activities are borderless. Several companies had moved their operations offshore in the late 1990s raising the risk of revenue loss. Customs predicted that if no change was made, between a third and a half of the UK betting market would be lost to offshore operators. In November 2000 the Committee of Public Accounts recommended that Customs 'need to address the risk through planned reforms of betting duty'.

1.11 In October 2001, in an attempt to encourage traders back onshore and to secure the remaining tax base,[21] the Government introduced legislation for general betting duty which changed taxing stakes to taxing gross profits (the difference between stakes wagered and payouts made). This became known as Gross Profits Tax **(Figure 6)**. The Gross Profits Tax was extended to pools duty in April 2002 and bingo duty in October 2003 as part of the modernisation of gambling taxes. A consultation exercise for introducing Gross Profits Tax for amusement machines ended in October 2003.

1.12 As stakes are now tax-free for the punter, the cost of betting has reduced and punters can bet more for their money. This has led to a rise in betting activity, and in order to exploit this new demand, traders have introduced new products. One of these, the Fixed Odds Betting Terminal (paragraph 3.4), has proved so popular that within three years it has become the largest component of betting revenue for some of the bookmakers. Its popularity has helped increase turnover, but its low profit margins mean that turnover has increased at a much higher rate than gross profits. For example, the turnover for major bookmakers such as William Hill and Ladbrokes has at least tripled, while they have reported 40 per cent increases in profits. It also explains in part the reduction in general betting duty revenue since the change.

20 HM Customs and Excise: *The Modernisation of Gambling Taxes: A Report on the Evaluation of the Gross Profits Tax on Betting*, May 2003, p.1.
21 The tax base is the sum of taxable activities, e.g. goods and services in the UK subject to tax. For the purpose of gambling duties, the tax base consists of all businesses offering betting and gaming to UK (and overseas) customers.

6 General Betting Duty – a comparison of its structure before and after the introduction of Gross Profits Tax in October 2001



Source: NAO analysis

NOTE

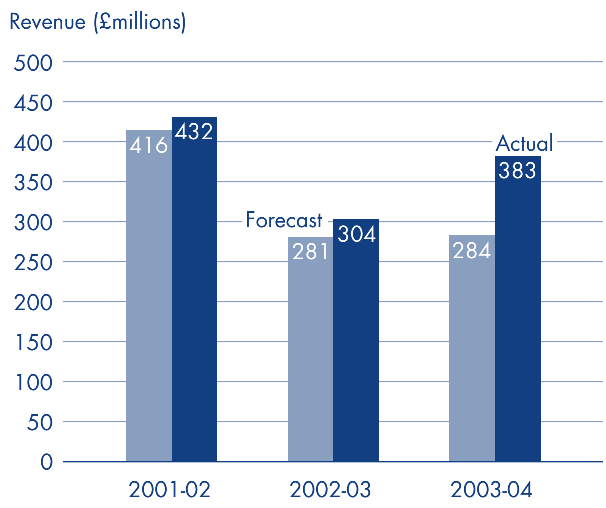
1 punter had the choice of paying 9 per cent of the gross stake amount (as in this example) or 0 per cent of the stake and 9 per cent of any winnings. Punters winnings of £920 based on effective betting duty rate of 1.2 per cent in 2003–04 (paragraph 1.14 refers) and that the rate of tax has effectively reduced from 6.7 per cent to 1.2 per cent.

1.13 Customs published its review of the introduction of Gross Profits Tax, 'Report on the Evaluation of the Gross Profits Tax on Betting'.[22] It concluded that the reform had been successful, and in particular industry turnover had increased, although margins are now smaller. The main impacts of the reform have been:

- **Maintenance of a UK based gambling industry** – The big operators, William Hill, Coral Racing, and Ladbrokes, have repatriated their offshore businesses and secured additional employment within the UK. Some smaller operators have so far not responded to the increased incentives to operate once more from the UK.
- **Consumer choice** – For the punter, it seems clear that the transfer of tax to the trader has made betting cheaper and improved choice and value. The revised structure allows the industry to absorb the tax and no longer charge it to punters, thus enabling them to offer bets without a direct deduction for tax to domestic and global customers from a UK base. There is no evidence that the betting odds offered to punters are in any way worse than before the change. Stakes on betting have now more than quadrupled since the introduction of Gross Profits Tax, from £7.1 billion in 2000–01 to £32.2 billion in 2003–04.
- **Safeguarding duty revenue** – Customs constructed a model with help from Nottingham Trent University and Nottingham University to forecast the effect of Gross Profits Tax on betting duty revenue. Two main assumptions were made. First, turnover would increase 35 per cent as a result of tax-free betting for punters. Secondly the duty per pound spent by the punter (the gross tax rate) would decrease by a factor of 2.25, reflecting the lower value of gross profits compared to turnover. The combined effect of these assumptions meant that Customs expected an initial fall in revenue when the Gross Profits Tax was introduced, since the decrease in gross tax rate would more than counterbalance the increase in turnover, but that eventually the trend would be reversed as turnover would further increase in a newly thriving betting industry, with revenues returning to their pre-Gross Profits Tax level within five years.

1.14 In the event both assumptions were considerable underestimates. Actual turnover has increased by 300 per cent in the three financial years to 2003–04, and the gross tax rate has declined from 6.7 per cent in 1999–00 to 1.2 per cent in 2003–04. The net result has been a higher than forecast revenue level for the first three financial years **(Figure 7)**. Our discussions with Customs, the industry and bookmakers indicated the differences between forecast and actual have been largely due to the emergence and unexpected popularity of Fixed Odds Betting Terminals in betting offices, with their very low profit and duty margins, and secondly to the competition of newly emerging betting exchanges.

7 Revenue levels are higher then forecast since introduction of gross profits tax



Source: NAO analysis of HM Customs and Excise data on General Betting Duty

22 HM Customs and Excise: *The Modernisation of Gambling Taxes: A Report on the Evaluation of the Gross Profits Tax on Betting*, May 2003.

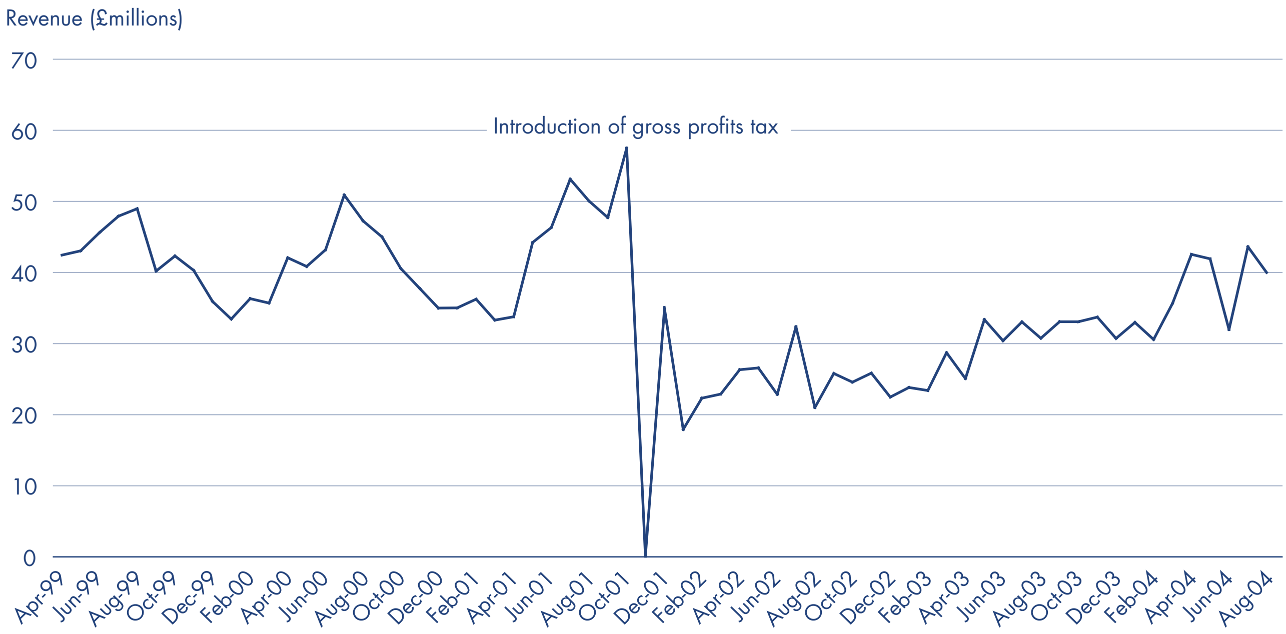
1.15 Unless turnover continues to grow strongly, it seems unlikely that revenue levels will regain their pre-Gross Profits Tax peak in the near future. Nevertheless, Customs considers that it is likely that revenue reduction under the old regime would have exceeded the decline recorded had no change been made as more and more businesses would have moved overseas. **Figure 8** shows the effect of the introduction of Gross Profits Tax on monthly duty revenue. There is a marked shift downward in duty revenue as Gross Profits Tax is introduced, followed by a slow climb thereafter.

1.16 Customs introduced Gross Profits Tax for pools betting in April 2002 to bring it in line with general betting duty and modernise the taxation regime. Following the introduction of the National Lottery, the popularity of pools went into sharp decline, and the Government was keen to explore options to help the industry survive. By lowering the effective tax rate, the effect on duty revenue has been to reduce receipts by a half **(Figure 9)**.

1.17 Gross Profits Tax was introduced for bingo in October 2003, with similar objectives to those for general betting. The bingo industry was consulted widely, although mixed views were received. One problem noted by many industry players was that gross profits were to be liable to both Gross Profits Tax and VAT on par fees **(Appendix 1)**, although overall tax would decrease. It is still early to make any conclusions on duty level and industry profit level trends, but the early signs are that the situation is similar to general betting, with turnover in the industry increasing, and at the same time duty levels decreasing.

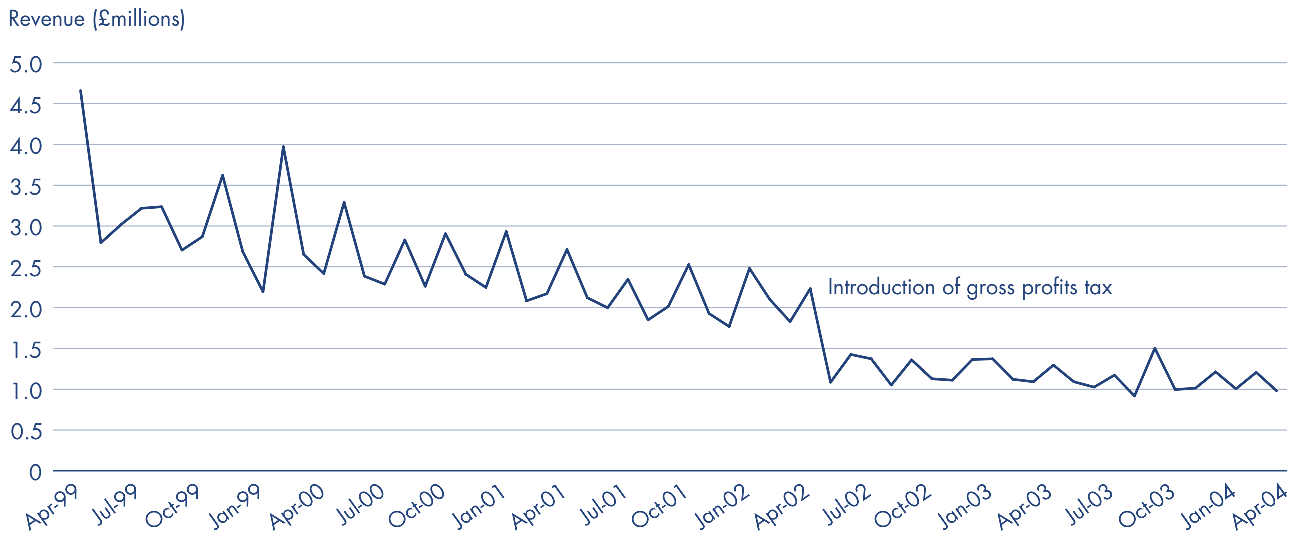
1.18 Overall the consumer has benefited from the introduction of Gross Profits Tax with cheaper bets and more choice. Most businesses and operations, though not all, have remained in, or been repatriated to the UK, securing jobs and other business tax revenues. Duty revenue from general betting has been higher than expected, although the effect on pools duty has been to in effect halve the revenue take.

8 General betting duty slowly climbing after the fall as the gross profits tax is introduced



Source: NAO analysis of HM Customs and Excise data

9 Pools betting duty steadily declining after introduction of gross profits tax halving receipts



Source: NAO analysis of HM Customs and Excise data

1.19 There is some good practice from the implementation of Gross Profits Tax, which should be applied to any further changes in duty regimes, such as:

- The industry must be fully consulted and be supportive of the changes (betting duty);
- Education of traders should be a high priority before, during and immediately after the introduction (betting duty);
- A careful calculation, based on realistic assumptions outlining various scenarios, of the impact on revenue of the change, must be carried out in advance and monitored closely after the change (betting duty); and
- A need to develop a clear understanding of how to confirm that traders are paying the correct amount of duty under the new regime (betting duty).

There are also some lessons from the implementation:

- Extension of a new method of collecting duty to other duty streams needs to consider the potential loss of revenue that would result against the benefits of bringing the duty in line with other duty regimes (pools duty);
- Update the Department's risk assessment and compliance activities so they are targeted on the risks posed by the new regime (all duties); and
- Complications with VAT must be resolved before introduction (bingo duty).

PART TWO

Customs' use of resources to meet the risks to revenue on gambling duties

This part of the report considers whether Customs' use of resources is effective in countering the risks to revenue. It finds that resources used on gambling duty work has nearly halved since 2000. Nevertheless Customs has made progress in developing its risk assessment and coverage of large businesses and is centralising its staff and records to improve the effectiveness of its assurance work.

2.1 In 2000 the Committee of Public Accounts noted that ongoing changes in Customs' arrangements for allocating resources across excise duties and VAT may reduce coverage of gambling duties. Given the scale of estimated losses of revenue at the time from illegal activity and error (£25–£100 million), the Committee highlighted the risk that these changes may result in insufficient resources being made available for gambling duties to ensure adequate coverage to protect and increase revenue levels. The Committee recommended that Customs should monitor carefully the costs and benefits of reducing coverage of gambling duties.

What are the risks to gambling duties?

2.2 In 2000 the main risks to gambling duties identified by the Committee[23] were from:

- **Losses from operators using amusement machines without licences,** in particular from over 60,000 small operators, and from machines sold independently from operator to operator. In response to this loss of revenue, estimated at £5 to £10 million a year in 2000, Customs introduced statutory powers to recover arrears of duty which has recovered £4.1 million in duty so far.
- **Losses from illegal bookmakers** – which the Department estimated at between £25 and £50 million in 2000, although registered bookmakers considered it could be as high as £100 million. In response the Department planned to undertake research into the revenue losses involved and set operational targets to identify illegal bookmakers. However, the introduction of Gross Profits Tax which offers the customer tax-free betting, and the emergence of high turnover, low-margin operations such as betting exchanges has removed one of the main reasons why punters bet with illegal operators. Trade associations such as the Association of British Bookmakers note that betting shops reporting the biggest increases in sales are in areas where illegal activity has previously been known. The industry also indicates a fall in illegal activity, for example prior to the introduction of Gross Profits Tax, Coral Racing received reports of illegal activity on a weekly basis, but after introduction there were no reports for six months. Reports to Customs of illegal activity have also fallen significantly.
- **Losses from the growth of telephone and Internet betting** with bookmakers overseas estimated at £15 to £20 million of loss of revenue a year. To counter this threat, the Chancellor announced plans in Budget 2000 to reform betting duty which led to the introduction of Gross Profits Tax in October 2001 (paragraph 1.11).

2.3 Since 2000 two factors have changed the risk profile, first the introduction of Gross Profits Tax for betting, bingo and pools, and secondly the development of technology, with the emergence of Fixed Odds Betting Terminals in betting shops and the expansion of remote gambling[24], for example e-gaming and betting exchanges. Customs considers that illegally operated amusement machines remain a risk to revenue. However, illegal bookmakers are less of a risk, as with the introduction of Gross Profits Tax, punters now can bet anywhere without paying tax. The risks are:

- **illegal operators** operating unlicensed amusement machines;
- **illegal suppression, and errors in recording, of bets (that is bets that are either unrecorded, or recorded incorrectly, in the books)** leading to understatement of gross profits;
- **illegal remote gambling activity**, for example where e-gaming takes place on a UK based site; and
- **money laundering activities,** particularly with increasing reliance on electronic transactions. These emerging risks are considered further in Part 3.

23 Committee of Public Accounts Report HC423 Session 1999-2000, November 2000.
24 Remote gambling is the term applied to a gambling activity which takes place usually via electronic means and away from the event being gambled on and a recognised gambling establishment such as a betting shop or casino.

Customs' approach to countering risk

2.4 Customs undertakes work across the duty regimes to address the risks to duty revenue including:

- **compliance work focusing on** traders posing the highest risk and **projects to target particular areas of risk, such as missing returns and debt recovery;**
- separately targeting the risks posed by **large businesses;**
- **risk assessments of small- and medium-sized bookmakers to target its resources;**
- **addressing the risks posed by unlicensed amusement machines;**
- placing reliance on the **work of other government agencies** for other duty streams and **consultations with the industry** particularly on changes to duty regimes;
- **risk assessments of small- and medium-sized betting exchanges and spread betters** to quantify the scale of the risk and target work; and
- **investigating illegal and non-compliant registered websites.**

2.5 Since 2000 Customs has allocated resources to areas across excise duties together judged by the highest risks to revenue. By estimating that gambling duties are relatively low risk, fewer resources have been made available. Customs allocated 41 staff-years to gambling duties in 1998–99, compared with 26 staff-years in 2003–04.

2.6 Customs has made better use of the resources available. It has refined its approach to risk assessment, segmented the trader population, and set up areas of expertise. This has involved centralising information on traders and bringing together experienced staff.

Results of work to assure trader compliance

2.7 The additional revenue generated by Customs' visits to traders has declined from £2.02 million in 2002–03 to £0.69 million in 2003–04 and in terms of the additional revenue generated per trader assessed from £4,343 in 2002-03 to £1,846 in 2003–04 (**Figure 10**).

10 Additional revenue generated by Customs' assessment of betting, gaming and bingo traders

Year	Number of assessments[1]	Additional Revenue[2] (£)	Future Revenue Benefit[3] (£)	Total additional benefit per trader assessed (£)
2002-03	85 high-risk	777,000	138,000	10,765
	76 medium-risk	444,000	298,000	9,763
	306 low-risk	350,000	21,000	1,212
Total	**467**	**1,571,000**	**457,000**	**4,343**
2003-04	36 high-risk	143,000	103,000	6,833
	29 medium-risk	96,000	75,000	5,897
	306 low-risk	214,000	55,000	879
Total	**371**	**453,000**	**233,000**	**1,846**

Source: NAO analysis based on HM Customs & Excise statistics

NOTES

1 The number of assessments – the number of traders who have been issued with assessments for additional duty payable.

2 Net additional revenue – actual revenue identified through visits to audit traders.

3 Future Revenue Benefit – the estimated monetary amount that will accrue for the 12 months after the visit. Future Revenue Benefit recognises that the impact of a visit stretches beyond detecting Net Additional Revenue during the visit itself.

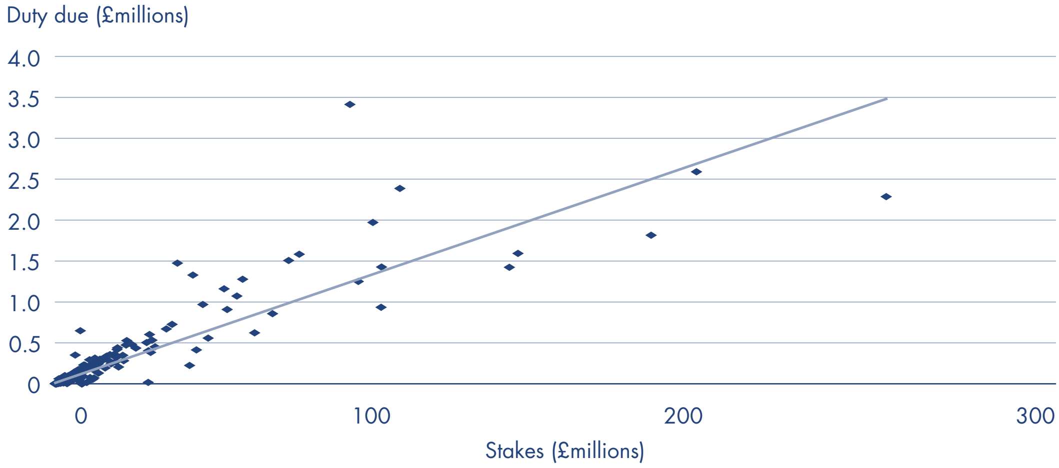
2.8 Customs used a new risk model for bookmakers (which make up the majority of visits) in 2003–04 to identify the higher-risk traders for visits by regional officers. The model assessed the credibility[25] of the traders and does not rank them according to the potential additional revenue to be generated. The Department considers the model tends to steer assurance activity to the smaller independent sector where there are fewer internal controls. This may explain the lower additional revenue generated from the high-risk cases. Another factor is the reduction in the effective rate of tax when Gross Profits Tax was introduced and over time the number of assessments relating to the period when the higher rate was in place has reduced. The fall in revenue generated from the visits over the two years may also indicate that as traders have become more familiar with the Gross Profits Tax regime the cases of error have declined despite duty receipts increasing from £304 million in 2002–03 to £383 million in 2003–04.

2.9 For 2004-05 Customs intends to make use of Best Judgment Assessments, which take a more rounded view of traders behaviour in assessing risk (paragraph 2.11). This could be enhanced by including some estimate of the likely additional revenue that would result from a compliance assessment in the risk ranking, supported by financial targets for Customs' compliance work.

2.10 Our analysis of over 1,000 small- and medium-sized bookmakers' returns examined the relationship of bookmakers' stakes to duty due for the financial year 2003–04. It showed where traders have a higher ratio of stakes compared to duty due than the average **(Figure 11)**, and this may indicate suppression of profits.

11 The ratio for stakes to duty due suggests that small- and medium-sized bookmakers may be suppressing profits

Stakes and duty take for small and medium sized businesses.



Source: NAO analysis of HM Customs and Excise data

NOTE

The line shows the best-fit for the relationship between stakes and duty due for small and medium size bookmakers.

25 The credibility of the trader return judges how credible the return is in terms of profit margins and turnover.

2.11 In support of its compliance activities Customs has also undertaken work to:

- **Identify missing returns** – Bookmakers are required to submit returns to Customs on a regular basis, the frequency depending on the size of the bookmakers. Our report in 2000 recommended that Customs should use computer software to interrogate the data on the accounting system to check traders submit regular returns to pay duties. In 2001 Customs identified 1,500 missing returns covering £17 million of duty with £4.5 million of receipts outstanding from traders over the previous three years and sent out letters requesting returns. This resulted in £4.5 million of revenue and a similar exercise is now carried out on a monthly basis in bingo and other regimes where returns are submitted.
- **Revoke bookmaker permits** – Bookmakers are required to renew their permit every three years. All work on objection and revocations of bookmaker permits is now managed centrally by Greenock Operational Team. Customs monitors debts of bookmakers and identifies those with a documented pattern of non-compliance and lodges an objection to the permit renewal with the appropriate local authority. In 2003–04 Customs raised an objection against three traders. This resulted in two bookmakers not getting their permits renewed and another paying their outstanding debt to Customs and then being granted a renewed permit.
- **Identify unviable businesses using best judgement assessments by comparison of duty revenue to the size of the business operations** – In cases where Customs suspects that the trader may be suppressing profits it can investigate this using best judgement assessments. By investigating their accounts, and comparing turnover and gross profits to expectations based on factors such as similar traders' results, seasonal factors, and even lifestyle, Customs can establish a picture of the overall credibility of the trader. In one case Customs investigated a bookmaker and issued a £3,000 demand for underpayment of duty as a result. From 2004–05 Customs intends to make more use of best judgement assessments, for future risk assessments and investigations based on industry benchmarks.
- **Debt management** – Since 2002 Customs has focused on improving trader compliance, both in getting their duty returns in on time and in paying outstanding duty. In 2003–04, 92.5 per cent of bookmaker returns and 98.8 per cent of bookmaker payments were received on time. This has involved regular reviews to identify missing or late returns, the use of warning letters, assessments and penalties and in a few cases revocation of licences (**Figure 12**). In 2003-04 Customs issued over 200 penalties for late or missing returns worth £50,000. It has reduced the debt outstanding from bookmakers and bingo operators by over £1 million since March 2003, from £3.5 million to £2.3 million at the end of 2003–04. Around £1.5 million of this is from de-registered traders.
- **Use of sanctions** – Customs sends warning letters to traders who have not submitted a return or payment by the due date. If the late return or payment is not received within a reasonable amount of time, a fixed penalty of £250 is issued. If the penalty is not paid, it is referred to the Debt Management Unit for recovery. Eventually legal proceedings may be considered. In 2003–04, there were some 1,200 late returns/payments, which led to 226 fixed penalties but only 99 were paid. Some 162 were wholly or partly unpaid and subject to recovery action by the Debt Management Unit. Customs does not know readily how many of these penalties remain outstanding as no separate record is kept. However a sample test of 10, revealed that 4 (40 per cent) were still outstanding after at least 6 months. Customs considers that having allocated additional resources to its Debt Management Unit from November 2004 it will be able to chase all outstanding debts. To improve the use of sanctions Customs should consider:
  - issuing penalties on the first occasion a return/payment is late, and considering a higher fixed penalty to provide a more effective sanction and cover administration costs;
  - making more use of geared penalties which relate the size of the penalty to amount of duty payable;
  - introduce an electronic service to enable traders to submit returns and payments; and
  - improve the management information in the use and effectiveness of the sanctions deployed.

12 Use of sanctions in 2003-04 to encourage trader compliance

Sanction	Numbers
Warning letters	606
Fixed penalty (£250)	226
Unpaid penalties referred to Debt Management Unit	162
Geared penalty	1
Objection to new applications (bookmakers only)	3
Licences made void (amusement machine operators only)	344
Machines seized	60
Criminal and civil prosecution cases	0

Source: NAO analysis of Customs data

NOTE

Some of the information on penalties and sanctions is not collected on a national basis by Customs – only four out of seven regions had the information readily available.

13 Findings from review of trader folders

Basic information on many folders was missing – such as registration documents and up-to-date information on the trader's address and the number of shops operating.

Audit methodology was often unclear – in terms of what work was carried out on a visit and why.

Reporting of findings was often unstructured and inconsistent – it was not always clear what the conclusion was, and conclusions that were given were often inconsistent with each other, for example some officers consider misunderstanding of the tax regime a fairly minor offence, when others issue warnings.

Lack of follow-up where problems were encountered – for example, it was not always clear what follow-up action had been taken in response to assurance visits.

Difficulties in obtaining management information on traders – using the exception reports procedure known as Crystal, to interrogate the Department's accounting system.

Source: NAO review of 30 Customs trader folders

Making better use of the results of compliance work to help inform risk assessments

2.12 Up to April 2004, records of trader activity, risk assessment work and assurance work were held in regional offices, and were fragmented and not collected or kept in a systematic way. This has led to difficulties in analysing the information for risk assessment purposes. To address the regional variations highlighted in the last NAO report, Customs provides staff with training and written guidance on each of the duties on how to undertake a system based audit of trader systems and techniques to confirm that the correct amount of duty has been paid. However, our review of 30 trader folders, covering bookmaker, bingo and amusement machine operators showed that whilst some good work had been done, information held on the folders, and the audits performed was variable **(Figure 13)**.

2.13 In recent years the most common errors found by the visits were: lack of understanding of the tax regime, badly kept records and suppression of bets (artificially reducing gross profit by not recording stakes taken in the books).

2.14 To improve consistency Customs has, since April 2004, centralised resources and created a gambling risk team based in Norwich. From September 2004 most trader folders had been updated into a standard format and new guidance and training courses are being developed. In addition the new team could improve assurance visits by:

- developing a standard programme to be completed in all audits of traders;
- quality assuring the findings of the audit by a supervisor, including a summary of future action points;
- applying recently developed practices on VAT assurance, where trade information has been transferred to electronic folders (a list of the types of information Customs could routinely collect is provided at **Appendix 5**).

Large businesses

2.15 Customs' Large Business Group is responsible for the VAT, Excise and Customs duties affairs of the largest 1,000 or so UK businesses, organised by trade. In September 2003 it brought all large gambling businesses under the control of one National Business Manager to better focus knowledge and expertise. In July 2004 the Large Business Group changed from geographical managed teams to trade sectors and all large gambling businesses and the National Business Manager were allocated to the Leisure sector. By July 2004, it had responsibility for 11 large gambling businesses, representing three-quarters (£1 billion)[26] of all gambling duty revenue. This includes the five largest bookmakers, two casino operators, two bingo operators, one amusement machine supplier, and the National Lottery operator. In 2003–04 almost three staff years were used to assure this group across all taxes and duties.

2.16 Customs considers large traders in the gambling sector fairly low risk, compared to other sectors due to the quality of traders' internal controls. The Large Business Group identifies the need for audits of companies' systems which are carried out by specialist audit teams in the Large Business Group. Because of higher work priorities, no audits have been completed on any of the 11 largest traders since the set-up of the Group in September 2003. However the Group plans to undertake eight audits in 2004–05 and as of October 2004 two were underway.

2.17 To inform assurance and compliance work the Large Business Group has so far concentrated on building relationships with the industry and other public bodies such as the Gaming Board. The Group has visited all eleven large traders to provide customer education and develop an understanding of large traders' business. This regular consultation has been welcomed by the industry.

Risk assessment of small and medium sized bookmakers

2.18 There are around 1,190 small- and medium-sized off-course bookmakers operating out of 2,700 shops in the United Kingdom, together contributing a quarter of total general betting duty revenue. A further 5,500 shops are owned by the largest five operators. Increasingly, independent bookmakers are being bought by the national chains, resulting in larger market share for the big industry players, which Customs considers will reduce the risk of duty suppression.

2.19 In 2002 Customs developed a risk model specifically targeted at bookmakers. Customs liaised with some of the largest bookmakers to determine an industry norm for bookmakers' betting profit margins and use this benchmark to provide a credibility check on bookmakers' reported profits across the industry. As the result of Customs visits in terms of financial impact for 2003–04 (Figure 10), and our analysis of the correlation between stakes and duty due show (Figure 11), the model needs to be refined further. Customs has found that the largest bookmakers are not representative for the industry as a whole, so the risk model needs to assess individual bookmakers against other businesses of comparable size, for example by developing benchmarks which reflect industry segments such as small bookmakers in rural, less affluent areas, betting exchanges, large nation-wide chains just outside the Large Business Group remit and bookmakers with Fixed Odds Betting Terminals. To refine this further Customs could include:

- using external research and wider economic factors when identifying trends in gambling, such as using information on trader activity, particularly for electronic betting;
- examining in more detail the ways in which margins, stakes and winnings fluctuate according to the size, location and type of bookmaker;
- making more use of internal research into avoidance strategies, researched by the Analysis Division;
- developing industry norms for all segments of betting, taking account of changes proposed under the Gambling Bill; and
- sharing its risk assessment with the proposed Gambling Commission, in order to draw upon its detailed knowledge of the gambling market.

26 Figure for 2002–03.

2.20 We commissioned Vivas Ltd to review Customs' overall approach to risk management of gambling duties as they had carried out a similar review for our report in 2000. They found that Customs is strong in some areas of risk identification, assessment and management, for example, it produces scorecards to assess likelihood and impact. But Customs could improve its risk assessment by:

- improving feedback from compliance work, to understand better what is happening at grass roots level and problems when evaluating the risk strategy approach;
- producing a risk log of all sources of error and tax evasion cases to help assurance teams identify cases of evasion;
- undertaking a random sample audit of traders to detect any new areas of error and avoidance.

Risks to revenue from amusement machines

2.21 Operators using amusement machines without purchasing a licence was identified as one of the main areas of risk to revenue in the Committee of Public Accounts' report in 2000 and the risks have remained largely unchanged. In June 2004 there were some 18,000 traders operating nearly 182,000 amusement machines. Amusement machine licence duty accounts for 11 per cent of gambling duties, although the revenue has fallen from £160 million in 1999–2000 to £144 million in 2003–04. This fall in revenue is due to a decline in the number of machines in recent years.[27]

2.22 In 2000, the loss of duty from operators not purchasing licences was estimated at £5–£10 million. The Committee of Public Accounts recommended that Customs must balance the need to reduce the loss of revenue, against the burden of control. Customs has changed its approach to a more desk-based review of data records, rather than visiting traders. Customs has focused on:

- **Pursuing arrears of duty from amusement machine suppliers and operators during periods of illegal operation** – In July 2000 statutory powers were introduced in order to enable Customs to recover arrears of duty (paragraph 1.8 refers). Customs has developed an initiative to check traders with non-consecutive licences, where there was a gap between the expiry date and the renewal date. Customs has, by November 2004, identified some 1,332 cases and has collected an additional £481,000 of revenue. Customs is keeping the initiative under review. Though it is still cost-effective it is likely to be subject to the law of diminishing returns in the future when an alternative approach may become more appropriate. Customs has instigated exercises involving seizure of unlicensed machines to complement the desk-based activity.
- **Identifying unlicensed traders** – The Committee of Public Accounts recommended that Customs improves its procedures for obtaining information from licensing authorities. Customs undertook a project which involved writing to 450 Magistrates Courts requesting their lists of licensed clubs. By comparing these with Customs' list of registered traders, Customs found that many licences were out of date and that 8 per cent did not have licences that tallied with Customs' records. Following investigation an additional £156,000 of revenue was collected from the traders.
- **Identifying unpaid VAT** – Bookmakers deploy machines that provide a maximum payout of £25. Takings from them are also liable to VAT once the registration threshold has been exceeded. There is a risk that bookmakers may exceed the registration limit but fail to register and account for VAT on such takings. Customs has addressed this in a pilot project which so far has resulted in £41,000 of VAT receipts from formerly unregistered traders.

27 The number of Category A video machines has fallen by 17 per cent between 2000 and 2003 as a result of competition from the home video games market. The number of Category D and E jackpot machines has fallen 9 per cent between 2000 and 2003, largely because of the decline in private members clubs. Source: HM Customs and Excise.

2.23 In July 2003 Customs published a consultation document on the ways of taxing amusement machines to replace the licensing system, including the possible introduction of a Gross Profits Tax. After consultation the current licensing regime remains unchanged for the present. Due to the diverse nature of the industry there may be merit in segmenting the traders further when carrying out risk assessment. Customs is developing joint intelligence work and a database with the Gaming Board and the industry.

Working with other public authorities to cover the risks of revenue loss on other duties

2.24 The majority of Customs' resources devoted to gambling duties are devoted to general betting and machine licence duties as these are considered the areas of greatest risk to revenue. For the remaining duty streams Customs relies on work with other public sector bodies:

- **Gaming Duty** – Gaming duties amount to over £150 million a year, but are seen as low risk. In 2003–04 two casinos were visited with no sign of irregularity from either. Casinos are regulated by the Gaming Board which monitors the financial performance of individual casinos to ensure gaming is fair and complying with regulatory requirements. Customs takes advantage of the Board's monitoring of casinos' activities. The Board also supervises casinos to monitor their compliance with Money Laundering Regulations.
- **Bingo Duty** – Customs also utilises the regulatory work of the Gaming Board to monitor bingo operators' activities and any new developments. Bingo duty, which brings in over £120 million per year, was reformed in October 2003 when a Gross Profit Tax was introduced. Customs is intending to develop a risk model for bingo traders similar to the one for bookmakers. Fifty per cent of all bingo traders were visited in 2003–04, as educational visits in preparation for the introduction of the new tax regime.
- **Lottery Duty** – Lottery duty accounts for 43 per cent (£550 million) of all gambling duties. Customs regards lottery duty as low risk, and takes advantage of work undertaken by the National Lottery Commission, although no formal assurance agreement exists between them. Every month the National Lottery operator Camelot electronically transfers the duty due to Customs' Accounting Centre. Customs' Large Business Group carries out the assurance work on Camelot.
- **Pools betting duty** – pools betting has halved since 2000, and now accounts for one per cent of gambling duty revenue. Customs' work on pools betting mainly concentrates on following up operators who have not submitted their returns. No visits were carried out in 2003–04 but five visits have been made so far in 2004–05. Customs considers that the results of these visits confirm that there is little revenue at risk, and in 2004–05 there has been an improvement in operators submitting returns on time.
- **Customs has also carried out some joint operations concerning VAT and Excise duties.** In one pilot project Customs investigated bookmakers that were not VAT registered, but had gaming machines on their premises, which did take them over the VAT threshold. As a result £41,000 in VAT was recovered.
- With the creation of HM Revenue and Customs there is further scope for working with parts of the Inland Revenue that deal with the direct tax affairs of gambling operators. Customs began in October 2004 to discuss with the Inland Revenue how it manages and structures its small- and medium-sized traders, exchanged guidance and training material, and considered setting up a forum to discuss gambling issues and share risk information on individual traders.

2.25 The Committee of Public Accounts' reports on 'Revenue from Gambling Duties'[28] and 'The Gaming Board: Better Regulation'[29] both recommended that Customs should benefit from a closer working relationship and greater exchange of information with other public bodies, in particular the Gaming Board. The Memorandum of Understanding, signed with the Gaming Board in 2000, specifies contact points and the information to be exchanged between the organisations. This has led to closer working with regular meetings, sharing of information and occasionally combined operations on illegal operators. In one combined Customs and Gaming Board operation 49 unlicensed amusement machines were seized across a number of sites and assessments of £37,000 were issued. A total of 60 machines were seized in 2003-04. A new Memorandum has been signed in November 2004 which updates and further strengthens the relationship between the two organisations.

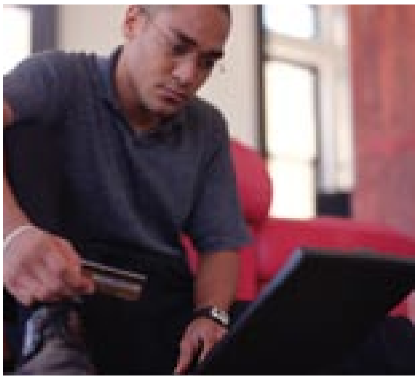
2.26 Customs assessed the option of setting up similar formal agreements with other public bodies, such as local authorities, but considered this unnecessary as informal working relationships are already strong at a local level and that contact with other bodies is widespread throughout the regions. More generally, our discussions with traders and industry representative bodies found that Customs regularly consults with the industry and that the industry considers these consultations to have been constructive particularly prior to any changes in the taxation regime.

2.27 Customs relationship with the gambling industry is generally good. An independent survey of 180 gambling businesses in 2004[30] indicated that there was high overall satisfaction, with Customs meeting business expectations. More businesses saw an improvement than a deterioration in Customs performance over the last three years. A high proportion of traders (67 per cent) were very satisfied and a further 28 per cent were fairly satisfied with the visits made to them by Customs. Fifty per cent of the traders visited said they were more confident about duty matters as a result of the visit and 51 per cent said they could think of nothing to improve.

28 Committee of Public Accounts Report, HC 423 Session 1999-2000.
29 Committee of Public Accounts Report, HC 611 Session 1999-2000.
30 HM Customs & Excise: Business Needs Survey 2004 carried out by FDS International May 2004.

PART THREE
Preparing for the future

This part of the report outlines how the gambling industry is changing and finds that there are a number of emerging risks which Customs is beginning to tackle, but that greater access to expertise in electronic based gambling, improved information sharing and work with other organisations are needed to safeguard revenue streams and maintain integrity of the tax regime.



Introduction

3.1 Since the mid 1990s, the UK gambling industry has been subject to rapid change due to the application of electronic and telephone technology to gambling and new products such as Fixed Odds Betting Terminals and betting exchanges. The Gambling Bill is expected to bring changes to the regulatory framework and enable the gambling industry to further diversify and expand its products.

3.2 Customs in developing its approach to trader compliance and protecting duty revenue also has to be alive to new risks from the growing diversity of gambling activity. Factors such as the number of businesses which decide to locate in the UK and consumer demand influence gambling duty revenue **(Appendix 6)**. As gambling has become more global and less constrained by national borders, the competitiveness of countries' tax regimes **(Appendix 1)** and regulatory frameworks will also affect the level of duty revenue. This Part outlines the ongoing and emerging changes and considers Customs' response to the risks to gambling duties from gambling and legislative change.

BOX 1

What is remote gambling?

Remote gambling is where the gambling activity takes place via electronic means and away from both the event being gambled on and a recognised gambling establishment such as a betting office or casino. It includes gambling on the Internet, telephone bets, interactive TV betting, and betting on mobile phones using 'WAP' technology. Under present UK law, remote gambling of all types can be legally played. However only the provision of remote betting, on real or virtual events, is legal. The provision of remote gaming is illegal, and must be played on non-UK-based sites.

Changes in the gambling industry

3.3 Estimates of the size of the remote-gambling **(Box 1)** industry are inherently difficult, since by its nature it is both paperless and unconfined to national boundaries but there is consensus that it is growing. Spending (stakes wagered) by UK players may be between £5 and £10 billion a year or as high as a third of all spending on betting, or a quarter of total gambling spending **(Figure 14)**.

Fixed Odds Betting Terminals (FOBTs)

3.4 Because of the high turnover, low-margin nature of Fixed Odds Betting Terminals **(Box 2)**, bookmakers' traditional profit margins are distorted. Whilst Fixed Odds Betting Terminals are a low-revenue risk Customs needs to refine its risk assessment of bookmakers' other activities to take account of them (Paragraph 2.9).

BOX 2

What are Fixed Odds Betting Terminals?

Fixed Odds Betting Terminals (FOBTs) are machines where players can bet on virtual events such as roulette and poker and the odds offered are fixed from game to game. They are classified as betting machines, and thus are liable to general betting duty (max stake £100 per spin, or £15 per chip placed). Fixed Odds Betting Terminals have become highly lucrative for traders to operate; for example they were responsible for 64 per cent of turnover in betting shops in the first half of 2004.[31] They are high turnover, low-profit margin machines.

31 Ladbrokes ltd. – results for first half of 2004.

14 Estimated spending on remote gambling

Activity	Description	Indicators of Size/Growth
Internet betting using bookmakers	Betting on real or virtual events with established bookmakers using the Internet to place the bet.	One in sixty adults placed a bet over the Internet in 2002, representing 735,000 people. Internet betting has grown from 1 per cent of market in 1999 to 5.5 per cent of market in 2003 (£1.5 billion of £27 billion wagered on bets).[32]
Telephone betting using bookmakers	Betting on real or virtual events with established bookmakers using the phone to place the bet.	Telephone betting has also grown in recent years, and it is now thought to make up about 7.5 per cent of the total value of bets wagered, about £2 billion in 2003.
Betting Exchanges	Betting on real events with other punters using an Internet-based exchange to match backers and layers. There are currently 21 exchanges registered with Customs, although some may not be operating.	Twenty-one betting exchanges were registered in UK in 2004. Bets wagered in 2003-04 amounted to £2.67 billion, with the market leader accounting for about 95 per cent of this figure.[33] According to their websites, commission ranges from 2 to 5 per cent of bets wagered.
Spread Betting	Betting on a spread of outcomes of real sporting and financial events. Punters use the Internet or the phone to place their bets. Twelve firms are currently registered with Customs.	Twelve traders registered in UK in 2004. According to Companies House, their combined revenue is in excess of £100 million, which implies that stakes are well over £1 billion, and rising fast.
Interactive TV betting	Using subscribed-for specialist interactive gambling TV channels e.g. 'Skybet' and 'Avago', to gamble on casino and other virtual games.	168,000 households placed a bet in 2002 with net expenditure of £6 million.[34]
Mobile phone betting	Use of WAP technology within mobile phones to place bets on real events.	£3 million net expenditure on bets in 2002.[35]
E-gaming	Casino games played on the Internet, such as roulette, blackjack and poker.	Estimates of worldwide revenues for firms supplying e-gaming in 2004 vary from £3 billion to £8 billion. Estimates of the annual growth rates vary from 20 per cent to 60 per cent. The number of e-gaming websites is now estimated to be about 31,000 compared to 650 in 1999. Spending by UK players is considered to be around 5–10 per cent of the worldwide market, which represents between £150 million and £800 million in 2004. In the UK, there are no duty revenues on e-gaming.[36]

32 The sources for these figures are:
Paton D, Nottingham University, & Vaughan Williams L, Nottingham Trent University, *Study of Gambling Duties: A Report for the NAO*, June 2004.
Ladbrokes Ltd, *Market analysis of the betting market* 2003.
HM Customs and Excise, *The Modernisation of Gambling Taxes: A Report on the Evaluation of the Gross Profits Tax on Betting*, May 2003.

33 HM Customs and Excise data.

34 Paton & Vaughan Williams, *Study of Gambling Duties: A Report for the NAO*, June 2004.

35 Ibid.

36 Spending on e-gaming is difficult to measure and no definitive figures exist at present. These figures were obtained from the following sources:
'Internet Gambling – an Overview of the Issues': United States General Accounting Office, December 2002.
Schema UK, *Online Gambling in Western Europe*, 2002.
Paton & Vaughan Williams, *Study of Gambling Duties: A Report for the NAO*, June 2004.
Interactive Gambling, Gaming and Betting Association UK, 2004.

Betting exchanges

3.5 Between October 2001 and May 2003, betting exchanges were charged duty on the aggregated winnings of one group of their customers – the 'layers' (i.e. those punters who offered bets to other punters), whom Customs decided to treat as bookmakers. After concerns were raised within the betting industry that this unfairly favoured the 'backer' and Customs' own research revealed that exchanges' effective tax rate was 5 per cent,[37] the basis of duty was changed from 1 June 2003 to be 15 per cent of commission, whether paid by backers or layers. The Government announced in March 2004 that there would be further work to establish a fair and equitable tax treatment for betting exchanges and their clients, and this is continuing.[38]

3.6 In 2003–04 betting exchanges paid £7.3 million in duty. From 2001 to 2003 Customs' work on betting exchange returns was the responsibility of local offices. There was little coverage except for the market leader by the Large Business Group. In 2004 one of Customs' local offices took responsibility for the remaining betting exchanges. It carried out an initial risk assessment, by analysing betting exchange trader returns to detect and quantify the risk of underpayment of duty. This has indicated a number of risks, such as very low commission rates, a wide variation in commission rates, and betting exchanges that submit low or nil returns. Customs has investigated a number of smaller betting exchanges and as a result four sites ceased operation. Customs are now looking at new exchange sites at the time of registration and monitoring their returns and payments.

3.7 We analysed the £7.3 million duty paid by the betting exchanges in 2003–04 against their declared commissions and their declared stakes and winnings. In three cases stakes and winnings were substantially different, and in six cases the commission declared was very small in relation to turnover. In six cases we also compared their declared commission percentages against their minimum advertised commission percentages on their websites. We discovered that in these cases the difference was considerable. This could be explained in a number of ways, for example commission could be taken against a punter's net winnings rather than against each individual win, disregarding the punter's losses. Any or all of these instances may or may not therefore indicate an underpayment of duty. The duty returns for betting exchanges do not include commission rates and therefore do not reflect the relationship between commission rate and turnover. Customs were in October 2004 working with the industry to devise an appropriate return.

Spread betting

3.8 With the introduction of Gross Profits Tax for general betting duty, duty is charged at three per cent for financial spread bets and 10 per cent for sports spread bets. Customs reviewed this policy in May 2003, and found the existing arrangements to be fair, with the only change being to allow financial spread bookmakers to carry forward losses to future accounting periods from September 2003.

3.9 The amount staked on financial spread betting in 2003–04 was over £1 billion and duty receipts were £5.1 million for the same period. Customs began in 2004 to improve its understanding of the industry to determine an effective compliance strategy. Customs has started to review the risks, which shows that much more work needs to be done to fully understand the industry, and determine an effective compliance strategy. An increase in spread betting carries a risk of reductions in revenue for other tax streams as punters gambling on financial indices can avoid capital gains tax, stamp duty and income tax on dividends, all or some of which would be paid if the financial index product or stock was bought directly. Customs should liaise closely with the Inland Revenue to monitor trends and potential losses of revenue in other tax streams due to spread betting.

E-gaming (and interactive TV and mobile phone gaming)

3.10 Gaming on the Internet and other electronic media is the most recent new gambling activity, and by law can be played but not supplied in the UK. The market for this product is likely to continue to grow but since supply from within the UK is currently illegal, there is no duty regime. Customs' role is to monitor UK sites, and prepare for the possible legalisation of supply in the near future. Customs has so far identified over 400 sites.

37 HM Customs and Excise, *The Modernisation of Gambling Taxes, Report on the Evaluation of the Gross Profits Tax on Betting*, May 2003, p.10.
38 HM Treasury, Budget 2004.

3.11 Reports by representative groups have made it clear that many e-gaming businesses would welcome regulation in the UK, and would be prepared to pay a premium to obtain it. This would imply a substantial new stream of duty receipts. This is likely to bring new risks, for example from alternative means of payment such as 'e-cash'. E-cash is electronic units of value that can be used for Internet transactions in place of normal currency. It can be issued by banks or other individuals in the form of smart cards. The General Accounting Office in the United States, in a recent report on Internet gaming found that many gaming representatives believe that e-cash will become the currency of the future for Internet gambling.[39]

Responding to legislative change

3.12 The Department for Culture, Media and Sport is responsible for the legislation regulating gambling. Over recent years it has been shown that the social legislation is unnecessarily complex and has failed to keep pace with changes in technology and public expectations. In December 1999 the Government announced an independent review body chaired by Sir Alan Budd to consider the current state of the gambling industry and the ways in which it might change over the next ten years and consider the social impact of gambling and the costs and benefits.[40] The 'Gambling Review Report' was published in 2001 and in 2002 the Government published its response, 'A Safe Bet for Success',[41] setting out the Government's key objectives for reform. The new legislation is underpinned by three main regulatory objectives; that gambling remains crime-free, that players know what to expect and are not exploited, and that there is protection for children and vulnerable people.[42]

3.13 The full Draft Bill was published in November 2003, and additional clauses were published in February and March 2004. The Bill was reviewed by a Joint Committee of both Houses of Parliament, which published its report in April 2004. The Government published its response in June 2004, in which they broadly agreed with the Committee and accepted 121 of the 139 recommendations. The Bill was introduced to the House of Commons in October 2004 (for Royal Assent in 2005, and for secondary legislation and the development of codes of practice to be in place by January 2007). It had its second reading on 1 November 2004 and was committed to a Standing Committee. The main aspects of the Gambling Bill are set out in **Figure 15**. These include the modernisation of the legislation governing casinos and the social regulation of the amusement machine industry. The Government intends to reconsider the tax position once the Bill has been introduced.

15 Gambling Bill main features

- Gambling Commission
  - To be established as soon as practicable after the Bill has become law;
  - New powers to intervene in detailed operation of gambling businesses to protect vulnerable people, including the imposing of fines;
  - Every trader/operator will have to comply with Gambling Commission codes of practice.
- Local Authorities
  - New powers to ban any or any further casino premises in their area.
- Child Protection
  - New criminal offence of inviting, permitting or causing a child to gamble.
- Remote Gambling
  - remote gambling, in the form of software providers, will be regulated for the first time.
- Casinos
  - New licensing system will be introduced, with three types of licence – 'Regional', 'Large' and 'Small';
  - Restriction on locations in which casinos can operate will be removed but more restrictions on granting a licence;
  - Number of gaming machines will be capped for each casino type;
  - Regional and large casinos will be able to offer bingo;
  - Unlimited prize money for some gaming machines;
  - Will be able to operate 24 hours and advertise services.
- Amusement Machines
  - New categories of machines – Categories A to D, with A being unlimited prize machines, but numbers strictly limited;
  - Slot machines to be banned from fast food outlets and minicab offices.

Source: National Audit Office

39 United States General Accounting Office, *Internet gambling – an overview of the issues*, 2002.
40 Gambling Review Body, *Gambling Review Report*, July 2001, p.6.
41 Department for Culture, Media and Sport, *A Safe Bet For Success – Modernising Britain's Gambling Laws* March 2002.
42 http://www.culture.gov.uk/gambling_and_racing/default.htm.

Money Laundering

3.14 Bookmakers or other forms of gambling are not yet covered by the Money Laundering Regulations **(Box 3)**. Recognising the links between betting and money laundering Customs is working with HM Treasury to identify possible money laundering activity in the industry. The Treasury is keeping the need to regulate betting under review. Gambling at bookmakers is a simple and relatively risk-free option for laundering money.[43] Typically, the money launderer makes frequent high-stake bets at very low odds, resulting in a minimal profit or, more usually, an overall loss. However, all winnings are effectively 'clean', since they are received in the form of cheques, payable either to the individual or to third parties. Betting exchanges also provide an opportunity to launder money. The customer can set up two accounts, bet against him or herself and receive a bona fide cheque from the betting exchange provider for the payout of the winnings. The Joint Committee Report on the Draft Gambling Bill report recommended that professional betters using betting exchanges should have to be registered, and the Government proposes that all exchange users should be identified and registered, not only the ones above a certain threshold. The new Gambling Commission will then have powers to access these records if required.

BOX 3

What is Money Laundering?

Money Laundering is a term usually used to describe the ways in which criminals process illegal or 'dirty' money derived from the proceeds of any illegal activity (e.g. the proceeds of drug dealing, human trafficking, fraud, theft or tax evasion) through a succession of transfers and deals until the source of the illegally acquired funds is obscured and the money takes on the appearance of legitimate or 'clean' funds or assets. The Money Laundering Regulations 2003 brought casinos into the regulated sector. Like other parts of the regulated sector, casinos are required to put in place procedures to identify their customers. They are also specifically required to obtain satisfactory evidence of identity of their customers before allowing them to use the casino's gaming facilities.

Implications for Customs

3.15 The growth of remote gambling as well as new developments as a result of legislative change all pose a risk to revenue which Customs has to counter. The main risks for Customs are:

- **Insufficient resources/expertise to undertake compliance work** – as remote gambling is paperless and the audit trail is electronic, Customs may increasingly need access to IT skills to interrogate complex computer systems. This is especially challenging for mobile phone and interactive TV channels, where the electronic records are often encrypted.
- **Not identifying all UK based traders** – The risks arise from ensuring that all UK based sites have been identified, and also that the full level of duty has been paid. This is made especially difficult when many traders either change website addresses or use a number of different addresses for the same trade.
- **Accuracy of declared duty** – once Internet traders have been identified and registered, the anonymity of Internet trading coupled with the variation in commission rates (for betting exchanges) makes it difficult to benchmark potential risk to revenue in the absence of transparent easily verifiable declarations of duty due.
- **Risk assessments do not reflect the variety of profit margins from different betting products** – one impact of Fixed Odds Betting Terminals has been to distort the industry-norm models Customs has used for risk assessment and credibility checks to check declared turnover. Customs is reviewing the format of the duty return and in the meantime relies on its officers to effectively audit all aspects of traders' activities.

43 National Criminal Intelligence Service.

The way forward

3.16 To address these risks and changes in the industry, Customs will need to work closely with the proposed Gambling Commission. A Memorandum of Understanding with the Gambling Commission may be needed and this should cover arrangements for joint working, risk assessment and information sharing. The extended powers of the Commission over the existing Gaming Board means that there will be scope for joint working on betting and e-gaming. Both authorities will particularly benefit from a joint approach to e-gaming as they will be able to combine a range of techniques to identify new operators and products as they come into the industry.

3.17 Following on from its recent restructuring of its compliance work, Customs will need to reflect the emerging risks identified above in its approach. In doing so it needs to review its compliance strategy, and training and guidance for staff undertaking this work. The guidance and training could be enhanced with specific guidelines for the audit of betting exchanges. For the audit of remote gambling, Customs could develop guidance on the systems checks which should be covered by compliance work. The compliance strategy, approach and guidance should be developed in close consultation with the Gambling Commission.

APPENDIX 1

Duty regimes in the UK and internationally

Duty regimes in the UK

Since the last NAO report in 2000, three of the six gambling duties have been reformed. Pool betting, bingo and general betting are now based on trader gross profits rather than punter stakes.

Lottery Duty

Lottery duty is charged at 12 per cent of gross stakes placed on all lottery games.

General Betting Duty

General betting duty was reformed in October 2001 and is now based on trader gross profits or commission, depending on the type of bet being placed. It includes the following:

- Bets placed with off-course bookmakers and the Tote (those placed with bookmakers at horse and greyhound meetings are tax-free). This includes bets on Fixed Odds Betting Terminals (FOBTs) within bookmakers' shops. Duty is levied at 15 per cent of trader gross profits i.e. the amount staked less winnings paid out;
- Bets placed with spread betting traders. Duty is levied at 10 per cent of gross profits for sports bets and 3 per cent of gross profits for financial bets;
- Bets placed on betting exchanges. Duty is levied at 15 per cent of commission receipts. In Budget 2004, the Government announced that it would review the taxation of betting exchanges.

Amusement Machine Licence Duty

All amusement machines provided for play on any premises in the United Kingdom require a licence unless they are specifically exempt (machines such as crane grab machines, children's rides, table football, snooker and pool, bar billiards, vending machines and juke boxes). Amusement Machine Licence Duty is payable for all gaming, video, pinball and quiz machines.

Duty amount depends on the category of the machine, which is determined by the cost per play and the maximum payout. There are five categories:

Category	Description	Stakes (pence)	Prizes (£)	Duty per month (£)
A	Non-gaming machines such as video, pinball and skill-with-prizes machines (quiz machines)	Over 50	Any	30
B	Small-prize gaming machines	Over 10	8 or less	80
	Medium-prize and jackpot gaming machines	5 or less	Over 8	80
C	Medium-prize gaming machines	Over 5	Between 8 and 25	85
D	Jackpot gaming machines	6–10	Over 25	170
E	Jackpot gaming machines	Over 10	Over 25	230

Gaming Duty

Gaming duty is based on the 'gross gaming yield' (stakes minus prizes) for premises where gaming takes place. Gross gaming yield consists of:

- the total value of the stakes, minus players' winnings, on games in which the house is the banker; and
- participation charges, or 'table money', exclusive of VAT, on games in which the bank is shared by players.

Gaming duty is charged on games such as baccarat, blackjack and roulette. Duty rates and thresholds are as follows:

Gross Gaming Yield	Rate (per cent)
The first £502,500	2.5
The next 1,115,500	12.5
The next 1,115,500	20
The next 1,953,000	30
The remainder	40

Bingo Duty

Bingo duty was reformed in October 2003 and is an excise duty on bingo games played in the UK. It is calculated as a percentage (15%) of the promoter's 'bingo promotion profit'. Bingo promotion profit is the difference, in an accounting period, between the promoter's bingo receipts and any expenditure he has on bingo winnings. Bingo receipts include payments entitling players to play bingo, such as: the cost of bingo cards, Mechanised Cash Bingo takings, and the VAT exclusive par fee. Bingo winnings are the actual amounts paid to, or value of prizes won by, players.

Pools betting duty

Pools betting duty was reformed in April 2002 to be levied at 15 per cent on gross profits (stakes less winnings). 'Fantasy sport' bets and similar competitions are also subject to pools betting duty, unless they fall within the new exemption to pools betting duty – for bets made for 'community benefit'.

International comparison of betting duty rates

Country	Betting duty rates
France	**13.83 per cent of turnover** on the French pari-mutuel[1] (the equivalent of the on course Tote in France) with 7.46 returned to racing.
Italy	Typically around **15 per cent of turnover** (comprised of two separate taxes one of which is currently 5 per cent and the Italian Government are considering lowering to 3 per cent).
Germany	All off-course betting is charged at **16.67 per cent of turnover** (the pari-mutuel tax is currently 28 per cent with 17.83 per cent returned to racing).
Australia	Tax on bookmakers is levied on turnover and gross profits and varies from region to region but a typical rate is the Australian Capital Territory's **14.25 per cent of gross profits and 1.25 per cent of turnover**.
Canada	The horserace-betting sector is taxed at both federal and provincial level. Betting tax varies from region to region, a typical figure being **Alberta's 28.76 per cent tax** including a 5.38 per cent provincial levy and a 0.8 per cent federal levy.
USA	Varies from state to state but typically the state takes a percentage of win bets and takes a higher percentage for multiple bets for example the takeout rate in **New Hampshire** for both horse and dog race betting is **19 per cent on win-place-show** bets and 26 per cent for multiple bets.

NOTE

1 Pari-mutuel betting is a form of betting offered at certain kind of sporting events in which participants finish in a ranking order, notably horse racing and greyhound racing. It is conventionally state-regulated, and offered in many places where gambling is otherwise illegal. Pari-mutuel betting is also offered at 'off-track' facilities, where players may bet on the events without actually being present to observe them in person.

Under pari-mutuel betting all bets of a particular type are placed together in a pool; taxes and a house 'take' are deducted, and pay-offs are calculated by sharing the pool among all placed and winning bets. In the UK the pari-mutuel is termed the 'Tote' ('Totalisator'). The simplest bet is a bet on a horse or dog to win, which usually elicits the lowest deduction, but there is a range of other bets, such as a bet on a horse to be placed (usually within the first three). An important perspective on pari-mutuel betting is that unlike many forms of betting or gaming, the gambler bets against other gamblers, not the house, bookmaker or market-maker.

International comparison of casino and amusement machine taxation rates

Country	Casinos
Canada	Canadian casino tax rates vary between regions, but are generally levied as a proportion of Gross Gaming Yield. Typical rates vary between 30 per cent and 40 per cent.
France	Casinos in France are taxed both at national and local level. At the national level casinos are subject to five types of taxes: flat-rate direct gaming tax; a progressive banded gaming tax; a CRDS (Contribution to the Repayment of Social Debt); a GSG (General Social Contribution); a tax stamp on entrance fees. Casinos must also pay a table tax and a negotiable charge aimed at supporting artistic, cultural and sporting events within a municipality.
Italy	Italy's casinos are taxed by the local governments, based on Gross Gaming Yield.
Germany	Casino taxation varies significantly between the East and West of Germany, ranging from 50 to 92 per cent of gross gaming yield.
Australia	Casinos are taxed at 20 per cent of gross gaming yield. In addition the industry contributes in both mandatory and voluntary funding to various community benefit funds.
US	Commercial Casino Tax varies radically between states, but is generally applied as a proportion of Gross Gaming Yield, ranging from 6.25 to 32 per cent.

NOTE

Gross gaming yield = stakes minus prizes.

APPENDIX 2
Methodology

Discussions with key stakeholders in Customs

We interviewed the Policy Development team and the various operational teams with gambling responsibility such as Excise Operations, Analysis Division, Accounting and Comptroller General and various Regional Business Services local offices (specialist teams) at Norwich, Salford, Greenock, and London. We also interviewed the Large Business Group at Watford, and their related trade sector consultant.

Discussions with industry and other government bodies

We interviewed key stakeholder groups from industry and other government bodies: Ladbrokes, Gala Group, British Horseracing Board, Association of British Bookmakers, British Amusement and Catering Trades Association (BACTA), Interactive Gaming Gambling and Betting Association (IGGBA), the Gaming Board for Great Britain, and the Department for Culture, Media and Sport.

Review of papers and reports

We reviewed a number of papers, pamphlets, reports and academic articles from gambling administrators, the gambling industry, and academia.

Review of trader folders

We examined a random sample of 35 folders of general betting, bingo and amusement machine licence duty small- and medium-sized traders to determine the quality and consistency of Customs assurance work in local offices. We used a structured audit programme which covered: completeness of basic data, such as operating licences and commercial information, risk assessment, assurance visits (including follow-up) and quality checks.

We also undertook individual case studies of five large traders, examining the extent and quality of risk assessment and assurance work.

Statistical analysis

Using custom made software, we analysed trends and patterns in duty paid, stakes, winnings and profit margins of bookmakers and betting exchanges over recent years to identify indications of risks.

Commissioned consultants

We commissioned Vivas Ltd to examine how Customs identify, assess and address risks to gambling duties, and compare to 1999 when the same consultants carried out a similar piece of work for our last report on Gambling Duties.

We commissioned Nottingham University and Nottingham Trent University to compare gambling duty regimes across the world (France, Italy, Germany, Australia, the USA and Canada), and also to investigate the state of remote gambling in the UK in all its forms.

We commissioned Oakleigh Consulting to help us construct maps depicting relationships between different bodies and outcomes within Customs and the gambling industry.

Analysis of company accounts

We reviewed the annual reports and accounts of the largest bookmakers and bingo operators to identify patterns in turnover and profits.

Advisory Group

We used an advisory panel of experts to comment on our emerging findings and recommendations. The membership of the group was as follows:

Frank Tucker – excise operational policy advisor
HM Customs and Excise

Tom Kavanagh – the Gaming Board for Great Britain

Elliot Grant – Head of Gambling and National Lottery licensing division, DCMS

Leighton Vaughan Williams – professor of economics, Nottingham Trent University

Progress against recommendations in Committee of Public Accounts Report on Gambling 2000

We examined the progress Customs has made in implementing recommendations made by the Committee of Public Accounts in 2000.

APPENDIX 3

Developments since 2000

2000

30 March

C&AG report **'Revenue from Gambling Duties'** (HC 352) which examines the Department's analysis and management of risks to revenue, and whether the Department's arrangements for deploying their resources are fully effective in meeting the risks.

1 November

The Committee of Public Accounts 39th Report of 1999-00 session publishes 'HM Customs and Excise: Revenue from Gambling Duties' (HC423 1999–00), which made two main recommendations; that the Department needs to be alert to emerging risks from for example Internet betting and make improvements to their risk assessment and control arrangements, and that the Department needs to monitor carefully the coverage of gambling duties to maintain regime integrity.

2001

1 February

Treasury Minute on the Committee of Public Accounts Report 'HM Customs and Excise – Revenue from Gambling Duties' published.

17 July

The **independent Gambling Review Body** led by Sir Alan Budd, publishes its report **'Gambling Review Report'** which made a number of recommendations for the reform of the gambling industry and its future.

6 October

Reformed **General Betting Duty** introduced. Bookmakers pay 15 per cent duty on the difference between the stakes laid with them and the winnings they pay out, instead of 6.75 per cent on stakes.

2002

26 March

Government publishes its response to the independent Gambling Review, **'A Safe Bet for Success'**, which sets out the Government's plan for modernising the laws governing gambling in Great Britain.

1 April

Revised **Pools betting duty** introduced, which levies duty at 15 per cent of net pools betting receipts, rather than at 17.5 per cent on the amount staked by players.

2003

May

HM Customs and Excise publishes 'The Modernisation of Gambling Taxes: a report on the **Evaluation of the Gross Profits Tax On Betting**, which concludes that the reform has achieved the Government's objectives.

1 June

Gross Profits Tax (GPT) reform: **betting exchanges** to pay duty of 15 per cent on the commission they receive (rather than 15 per cent of aggregated profits of all bet 'layers')

14 July

HM Customs and Excise announces **'Consultation on the Review of Amusement Machine Licence Duty'**, which examines alternatives to the licensing duty structure for amusement machines (consultation to last until 6 October 2003).

15 July

Part One of **Draft Gambling Bill** published by Government.

2003 (continued)

27 October

15 per cent tax on **gross profits of bingo companies** introduced to replace bingo duty, previously levied on a percentage of weekly stake and added prize money.

19 November

Major sections of **draft Gambling Bill** published by Government.

26 November

Draft Bill to be scrutinised by a **Joint Committee of both Houses** of Parliament and the **Department of Culture Media and Sport announces public consultation** on the draft Gambling Bill – to last until 28 February 2004.

2004

12 March

Additional clauses of draft gambling bill published.

8 April

Joint Scrutiny Committee publishes its report on the draft Gambling Bill, which comments in detail on the Bill and made 139 recommendations suggesting modification to either the clauses themselves or the underlying policy.

14 June

Government publishes its response to the first report of the Joint Committee on the draft Gambling Bill, which accepts 121 of the 139 recommendations.

18 October

Bill introduced in the House of Commons.

19 October

Bill published.

1 November

Second Reading of Bill followed by commitment to Standing Committee.

Sources: HM Customs and Excise, Inland Revenue, Department of Culture, Media and Sport, HM Treasury

APPENDIX 4

Action taken on Committee of Public Accounts report 'Revenue from Gambling Duties'

Committee of Public Accounts' recommendation	Treasury Minute response on proposed action by Customs	NAO assessment and Customs' action
i. Amusement Machines: Customs need to reduce the loss of revenue, estimated at £5 to £10 million by focussing on risk assessment and improving its ability to respond, for example through statutory recovery powers to reduce the revenue losses without increasing the burden of control on operators.	New statutory recovery powers came into effect in July 2000. In first six months 40 actions were brought. Action will continue.	**Fully met and work ongoing.** Customs has made use of the new statutory powers introduced in July 2000 to recover arrears of payment to reduce the revenue lost each year from unpaid duty. These powers enabled Customs to demand arrears of licence duty up to three years overdue. For the three years 2001 to 2003, Customs issued 5,116 retrospective demands totalling nearly £5.5 million of overdue revenue, which has resulted in actual revenue received of over £4.1 million.
ii. Illegal betting: Illegal betting poses a higher risk – £25–£100 million losses. Customs should complete research into the exact size of the tax gap and set targets for each of its collections to identify illegal bookmakers.	A two-year rolling research programme into tax gap, including a review of illegal activity measuring criteria was to be completed by June 2001.	**In progress – illegal betting has declined with the introduction of Gross Profits Tax but Customs needs to estimate the tax gap remaining.** The change in the basis of general betting duty measurement from customer stakes to trader gross profits in October 2001 has resulted in a significant reduction in illegal bookmakers. The likely explanation is that since consumers can now place a bet tax-free there is no incentive for them to use an illegal bookmaker to avoid tax. Stakes with licensed bookmakers have increased significantly since the introduction of gross profits. Customs has deferred work on measuring the tax gap[44] initially due to be completed in 2001 to allow for changes from the introduction of Gross Profits Tax to take effect. Customs has developed a methodology and the work is due to be completed by 2006 once the required surveys are completed during 2005. This work will identify the extent of the tax gap and enable Customs to focus on the causes, for example from traders taking bets without properly recording them. Targets not set, but cases dealt with on an individual basis.

44 The tax gap is the gap between actual duty collected and the duty that would be collected provided everyone paid the correct amount of tax.

Committee of Public Accounts' recommendation	Treasury Minute response on proposed action by Customs	NAO assessment and Customs' action
iii. Telephone and Internet betting: Customs needs to address the potential increase in revenue loss from increased Internet and telephone betting (£15-20 million in 2000) in a rapidly changing environment. Customs needs to address the risk through planned reforms of betting duty and by working with the Organisation for Economic Co-operation and Development (OECD) on ways of modernising tax regimes and shifting tax to other parts of the business chain.	Betting duty to be reformed as a result. Co-ordinated a survey of OECD members to gauge perceived threats to e-commerce. Half said their revenues could be under serious threats in the future.	**Fully met.** Reform of betting duty has largely brought telephone betting back onshore.
iv. Closer working: The Committee expect Customs to take the lead in developing and improving co-operation and cross-sector working amongst the other public bodies with responsibilities for gambling.	Customs signed a Memorandum of Understanding with the Gaming Board in 2000, updated in 2004, which covers sharing of information. Others were in the pipeline.	**Fully met. Work ongoing to develop closer working in the light of new threats and opportunities from technical developments.** There is continuing joint working with other public bodies such as the Inland Revenue. Regular contacts at local, regional and national level are maintained with many other public bodies. There are examples of where joint working with local authorities and police has resulted in direct action to remove unlicensed gaming machines and in closing down illegal traders.
v. Adequacy of resources: Customs should keep the level of coverage for individual gambling duties under review to ensure that the integrity of individual duties are adequately protected (as Customs' new risk model will allocate resources on the basis of total risks to revenue covering both excise duties and VAT).	The approach to risk management is designed to protect the integrity of individual taxes and duties. It works on the basis of relative risk and targeted assurance action. Customs does monitor the results.	**Fully met.** Less resources have been devoted to Gambling Duties since the introduction of the assurance model, for example 26 staff-years were allocated to Gambling Duties in 2003–04 compared to 41 staff-years in 1998–99. Customs has set targets for assurance coverage for each year since 2001–02. For example in 2003–04, 25 per cent of bookmakers, 10 per cent of casino and bingo traders, and all amusement machine suppliers and operators who paid Customs more than £50,000 in duty were targeted for a visit by assurance officers.
vi. Variation of coverage: There are unexplained variations between coverage by individual Collections (regions). Customs should improve consistency of treatment across traders and regions.	From 2000 Customs introduced a new business assurance model to allocate excise and inland customs assurance resources according to levels of risk. This was aimed at greater consistency in the selection and treatment of traders and to minimise any unjustified regional variations.	**Fully met.** System has changed since 2000 with the introduction of a 'one-stop shop' in Greenock for the whole of UK, and specialist teams in Salford, Norwich and London. In 2004 Customs has centralised its operations to improve consistency.

APPENDIX 5

Information Needs

Management information

Database for all traders:

1 Start and expiry date for Departmental licence to operate;

2 Record of returns submission: dates due and dates received for all returns in previous years, key relevant financial information (stakes, winnings, payouts, commission, etc.);

3 Debt details: how much is owed and from when, and what reminders have been sent etc.;

4 Record of liaison with assurance work on VAT and other tax regimes, including highlighted compliance concerns.

Performance indicators:

5 Returns and payments (each quarter for all duty regimes):

- Percentage of returns submitted on time;
- Percentage of forms filled out correctly;
- Percentage of payments submitted on time;
- Number of penalties issued and percentage paid;
- Number of traders issued with legal action – civil and criminal;
- Number of illegal amusement machines seized.

6 Effectiveness and efficiency of assurance work (by region and duty regime):

- Number of visits undertaken;
- Additional receipts secured as a result of assurance visits by risk category;
- Resources used in assurance work – cost of assurance work (research, correspondence, visits, etc.) for each trader measured by staff hours and staff expenses (T&S).

7 **Other**

- Duty rates for all regimes each year, measured by duty receipts divided by trader turnover;
- Gross profit margin for all bookmaker, spread betting and bingo traders measured by gross profit divided by turnover;
- Average commission for each betting exchange measured by duty receipts divided by 0.15 and comparison with minimum commission advertised.

All Trader Folders should contain the following information (ideally on electronic folders):

1 Up-to-date basic information on:

- registration documents – such as licences from relevant local authorities and magistrates courts and latest permit from Customs;
- commercial operations - such as: latest address of head office; the number and addresses of all operating shops; sets of accounts for previous years.

2 Risk assessment – standard form showing latest assessment of risk and supporting reasons such as: application of risk model, previous knowledge, gross profit margins, etc.

3 Assurance work – details of all contacts with the trader:

a Record of contact – standard form including separate sections for the different types of contact – correspondence, phone calls, and visits. Details should include when, where, who was present and what happened;

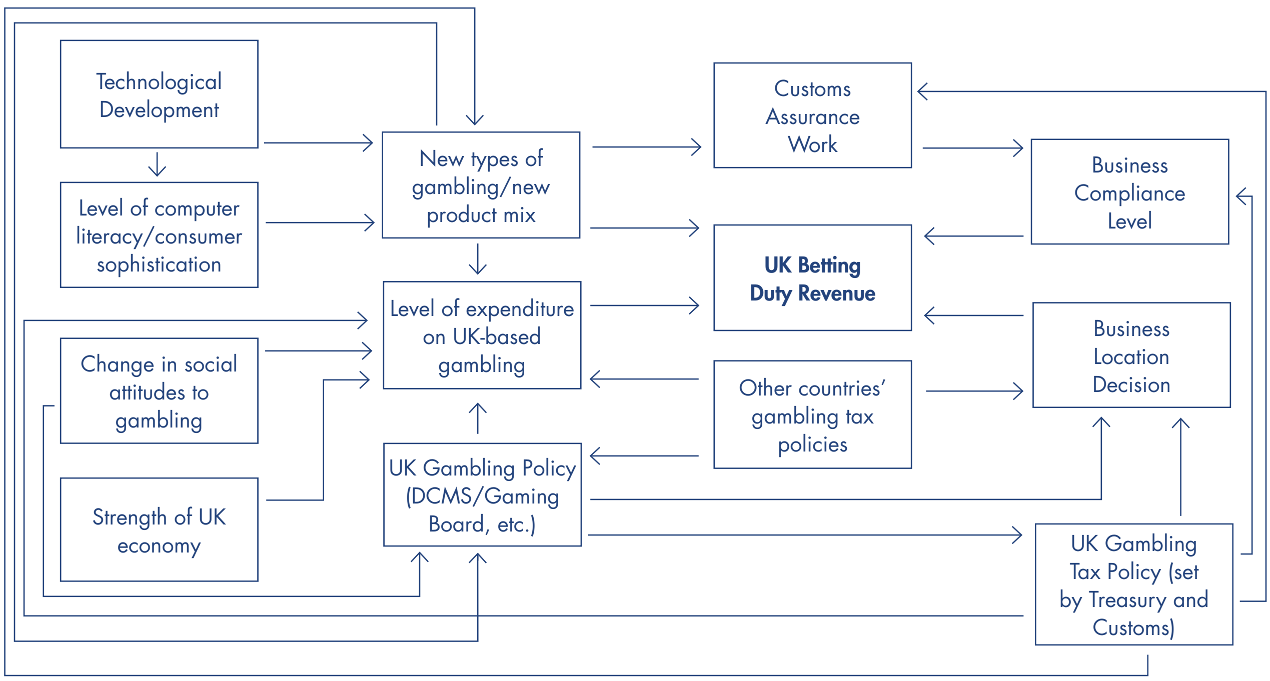
b Standard audit programme for visits – covering key audit objectives of accuracy and measurement, with all evidence referenced to the audit programme. There should be an audit conclusion and a list of follow-up work where necessary;

c Details of follow-up work – where relevant, including details of any penalties issued and paid.

4 Details of discussion with other public bodies about the trader – such as the Gaming Board, the police, the Inland Revenue, etc.

APPENDIX 6

UK Betting Duty Revenue Influence Diagram



Source: National Audit Office

The map identifies the key influences and main variables affecting UK General Betting Duty, which is the most complex of the six gambling duty streams. It is not meant to be exhaustive in showing all influences and all variables, but broadly illustrates the influences of technology, social attitudes, economic factors, government policies (UK and overseas) and business behaviour on the level of betting duty revenue. The map uses arrows to depict the direction of influence (the variable at the tail of the arrow exerts an influence upon the variable at the head).

The focal point of the map is 'UK Betting Duty Revenue'. It is affected by four key influences: the extent of business compliance, the number of businesses that base themselves in the UK, the level of spending on UK-based gambling by consumers, and the gambling product mix at any one time (where each product has a unique profit margin). Customs can affect two of the key influences directly (business compliance levels and location decisions) but can only affect the other two indirectly at best. It can, however, prepare for their changing influence, and this is largely the subject of Part 3 of the report.