



HM CUSTOMS AND EXCISE
Gambling Duties

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 £1.35¹ 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 2000³ 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 cent⁴ 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.

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.

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

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 gap¹⁰ 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.