

**EXPLANATORY MEMORANDUM TO
THE VALUE ADDED TAX (BETTING, GAMING AND LOTTERIES)
ORDER 2005**

2005 No. 3328

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Description**

- 2.1 This Treasury order amends Group 4 of Schedule 9 to the Value Added Tax Act 1994 ("the Act") by changing the definition of "gaming machine" in Note (3).

3. **Matters of special interest to the Select Committee on Statutory Instruments**

- 3.1 None.

4. **Legislative Background**

- 4.1 Group 4 of Schedule 9 to the Act exempts from VAT most forms of betting, gaming and lotteries. However, Note (1)(d) to the Group excludes the provision of a "gaming machine". That expression is defined in Note (3).

- 4.2 The new definition in Note (3) to Group 4 uses section 235 of the Gambling Act 2005 as a template. However, extensive adaptations of the exceptions and other provisions in subsection (2) *et seq* have had to be made in order to render them suitable for use with VAT. In particular, new conditions have been added to maintain the current position, whereby the takings from certain machines are not liable to both VAT and certain excise duties. Also, it would not be appropriate to reproduce those provisions that refer to orders and regulations made by the Secretary of State, as that would have the effect of conferring those powers again here (that would not only be unnecessary, but would render this order *ultra vires*). Many of the exclusions from the definition of gaming machine have no application here. For example, the Gambling Act needs to distinguish between different forms of bingo (e.g. prize bingo) in order for it to impose different licensing regimes, but such a distinction is not appropriate for VAT purposes. Lotteries and lottery terminals are not mentioned, because the exclusion for gaming machines applies only to item 1 of Group 4 (betting and gaming), and not item 2 (lotteries) in any event.

- 4.3 The Committee will note that the new definition of gaming machine contains several references to the Gambling Act 2005 and other legislation.

Although it is accepted that users of secondary legislation should be spared the necessity of having to refer to other legislation to make sense of it, the Department felt that this was unavoidable here. Reproducing the various provisions from these other Acts would greatly increase the length and complexity of the order (and, therefore, of Group 4 of Schedule 9). More importantly, perhaps, there is a need to ensure that the concepts used for VAT are precisely coterminous with those employed elsewhere. Apart from importing definitions from the Gambling Act for this purpose, this required excise duty charging provisions to be referred to.

5. Extent

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to the Treasury, John Healey MP has made the following statement regarding Human Rights:

In my view the provisions of the Value Added Tax (Betting, Gaming and Lotteries) Order 2005 are compatible with the Convention rights.

7. Policy background

7.1 Although most betting and gaming is exempt from VAT, the net takings¹ of ‘gaming machines’ are liable to VAT at the standard rate. The definition of gaming machines for VAT only covers those machines where the element of chance in the game is provided by means of the machine.

7.2 The definitions of a gaming machine in VAT and excise law have traditionally followed those in the social law applicable to the different forms of gambling. The social law definition has been updated by the Gambling Act to reflect new technology. A new definition for VAT purposes that uses section 235 of the Gambling Act as a template is accordingly desirable.

7.3 Section 235 of the Gambling Act has not taken effect yet, because the requisite appointed day order has not been made. Bringing forward the adoption of the new definition of gaming machine (rather than waiting for section 235 to be brought into force) will have the effect of removing the scope for legal challenges based on an alleged breach of fiscal neutrality. Following the judgment of the European Court of Justice in the case of *Linneweber*², that German VAT law contravened the European Community principle of fiscal neutrality by exempting gaming machines in casinos while taxing similar machines in other establishments, operators of taxable gaming machines in this country are submitting claims for refunds of the VAT they have paid over the last three years.

¹ Section 23(2) of the Act requires allowance to be given for payouts, so that VAT is not charged on total stakes inserted into the machine.

² *Linneweber and Akritidis* (Joined Cases C-453/02 and C-462/02; unreported)

7.4 Bringing forward the adoption of the new definition of gaming machine will also clarify the VAT liability of machines whose random number generator is not located within the outer casing of the machine, in light of recent attempts at avoidance through reconfiguring machines, by putting it beyond doubt that the location of the random number generator is irrelevant. At present one of the features that must be present for a machine to be a gaming machine is that “the element of chance in the game is provided by means of the machine” (Note (3)(c) to Group 4).

7.5 We do not accept that the avoidance is successful, or that there has been any breach of fiscal neutrality, but this change in definition will ensure that there is little room for doubt that all machines used for gambling are within the scope of VAT. It will thus protect VAT revenues from gaming machines for the future.

7.6 Although the new definition will have been implemented immediately by this Order, the similar definition of a gaming machine in section 23 of the Act can only be amended by primary legislation. In the meantime, the provisions limiting the amount upon which VAT is charged will not apply to any machines that were not previously treated as gaming machines. To deal with this anomaly, Ministers have announced that the Department will be collecting the VAT on only the net takings until the necessary clause in the Finance Bill 2006 is enacted. It is proposed that the clause will be retrospective back to the date this Order came into force.

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum.

8.2 There is no significant impact on the public sector.

9. Contact

Phil Sears, H M Revenue and Customs, CT&VAT, Social Reliefs Team,
3E/14, 100 Parliament Street, London, SW1A 2BQ
Telephone: 020 7147 0551
e-mail: phil.sears@hmrc.gsi.gov.uk

REGULATORY IMPACT ASSESSMENT (RIA)

1. Title of proposal

Clarification of definition of gaming machine for VAT.

2. Purpose and intended effect

Tax definitions of a gaming machine have traditionally followed social definitions. The Gambling Act has updated social definitions to reflect new technology that allows gaming machines to operate with remote random number generators and therefore to bring them into the category of 'gaming machine'. It is therefore necessary to make changes to the tax law definitions of a gaming machine, for both VAT and excise purposes, to reflect the Gambling Act.

Although most betting and gaming is exempt from VAT, the net takings of gaming machines are liable to VAT at the standard rate. The definition of gaming machines for VAT covers those machines where the element of chance in the game is provided by means of the machine. This has meant that some machines have fallen outside of the scope of VAT by virtue of a remote random number generator and there have been recent attempts to avoid VAT by reconfiguring machines so that the random number generator, which determines the outcome of the game, is sited outside the machine.

Additionally, following an ECJ decision, in the case of Linneweber, that German VAT law contravened the European Community principle of fiscal neutrality by exempting gaming machines in casinos while taxing similar machines in other establishments, operators of taxable gaming machines in this country are submitting claims for refunds of the VAT they have paid over the last three years.

We do not accept that the avoidance is successful, nor that there has been any breach of fiscal neutrality, but in order to clarify the VAT definition of 'gaming machine' and bring it into line with that to be used in social law, this Order changes the definition of gaming machines for VAT, so that it is based on the definition contained in s235 of the Gambling Act 2005 (although that has yet to be brought into force), and ensure that all gaming machines are within the scope of VAT, protecting the VAT revenues from gaming machines for the future.

This change applies to the whole of the UK.

3. Consultation

None. This is a measure designed to retain the status quo intended by the legislation.

4. Options

1. Do nothing. This would leave us open to the risk of VAT avoidance and legal challenge.
2. Amend definition of gaming machine in VAT law so that it is based on the definition used in social law.

5. Costs and benefits

The only sectors affected are those involved in leisure businesses where some machines used for gaming are currently classified as being exempt from VAT, in particular, betting shops and some amusement arcades. It is estimated that about 300 bookmakers, not already registered, will have to register for VAT as a result of changing the liability of the machines operated in such locations.

The benefit of the change will be that all operators of gaming machines will be treated the same and costs to comply are minimal.

6. Small Firms Impact Test

Minimal effect on small business. This measure will result in a small number of bookmakers (fewer than 300) having to register for VAT over coming years.

7. Competition assessment

Competition filter applied. This measure will aid competition as it puts all gaming machines on a level playing field.

8. Enforcement, sanctions and monitoring

Through HMRC's usual procedures.

9. Implementation and delivery plan

Guidance on the measure will be made available on the same day the Treasury Order is published.

10. Post-implementation review

A review of the effects of this measure will be conducted 1 – 2 years after implementation.

11. Summary and recommendation

To amend the definition of a gaming machine as described in option