



18<sup>th</sup> January 2013

## **André Wilsenach comments on UK Tax Developments**

AGCC has today published a third party overview, by tax advisers E&Y, of the position of licensees in the jurisdiction. This follows the recent clarification of EC rules on the place of supply for VAT purposes.

Executive Director Andre Wilsenach comments: We are pleased to note the opportunities for AGCC licensees that may arise from the EC clarification. These turn on the correct location of licensees key processes, for which it is highly likely that professional advice will be required.

*Please see article attached below*

## Location, location, location

### Introduction

**Gavin West, Director of Betting and Gaming at Ernst & Young reflects on the potential indirect tax issues facing on-line gaming companies following recent changes in the EU VAT rules relating to the place of supply of services.**

**During his 11 years of working within the industry Gavin has experience of advising a wide range of key stakeholders including operators, suppliers, trade associations and regulatory bodies. Gavin is currently responsible for Ernst & Young's Indirect Tax team's service offerings to the betting and gaming industry across UK and Ireland. He can be contacted at [gwest@uk.ey.com](mailto:gwest@uk.ey.com)**

### Speed Read

- The EU VAT rules relating to the place of supply of services were clarified with effect from 1 July 2011
- On-line operators with central service functions located in the UK or EU may be at risk from irrecoverable VAT on services received by on line gaming operating company
- Such costs could increase P&L and capital expenditure by more than 20%
- The UK authorities are now seeking to challenge businesses within this sector
- It would be prudent for on-line gaming operators to review their current arrangements to ensure that they are effective under the new rules

### Background

Prior to 1 September 2007 it was illegal for on-line gaming companies to establish their operations in the UK. As a result, during the early 2000's many operators and service providers set up businesses in offshore jurisdictions such as Alderney. Due to the fact that Alderney has no gaming tax or VAT regime this also created a tax advantage for operators based there as betting and gaming is VAT exempt in the UK meaning that UK-based companies are not entitled to recover any VAT they incur on expenditure associated with these activities, thus increasing their operational costs.

When the Gambling Act 2005 was fully introduced in the UK, with effect from 1 September 2007, on-line gaming was legalised. However, UK government simultaneously introduced a gaming tax, Remote Gaming Duty which would require operators establishing their business in the UK to pay 15% of the gross win generated. This, coupled with the potential irrecoverable VAT on associated costs, created an unattractive indirect tax regime for industry and many found the option of relocating business to the UK financially unviable. In addition, operators were satisfied that Alderney had implemented stringent procedures and controls within its licensing regime ensuring that the industry sector was, and remains one which is extremely well regulated.

### 'Establishment'

The place of establishment of a business is crucial in determining its exposure to indirect taxes. This is

a complex area of VAT law and any business setting up in, or relocating to, an offshore location must fully understand the effects of the relevant rules if they are to manage their indirect tax position effectively.

There are two main 'establishment' concepts recognised in EU VAT law:

where a company has established its business which is typically where its headquarters is located, the place where central administrative functions are carried out, and usually the country where it is legally constituted. In summary, this is the main business establishment and is located in a single country; and,

fixed establishment comprising human and technical resources located in one or more other jurisdictions. The nature and extent of the functions performed by such resources are key to determining whether the business has a fixed establishment, and the position differs according to whether the business is receiving or making supplies.

Moreover, situations can arise where the resources of one entity can create a fixed establishment of another (notably in dependent agent situations) so the mere fact that a company has no employees or other resources of its own in a country is not always conclusive.

Where a company has more than one 'establishment' then to determine the place where services are supplied or received, which in turn provides the VAT treatment for those supplies, a company must look to which establishment is most directly concerned with the supply.

## **Legal Background – 1997 – 2009**

Under the VAT rules in force at the time, the place of supply of services (and hence the country of taxation) varied according to the particular type of service being supplied. In summary, services were taxed in the country of the supplier entity unless an exception applied. The main exceptions were a wide range of intangible services including consulting, copyright and intellectual property, advertising, legal and accounting services, telecoms, electronically supplied services and broadcasting. These, in a business-to-business context were taxed in the country of the customer.

By locating their business establishment in Alderney, operators sought to obtain many of the back-office support services free of UK VAT. In particular, central support functions, including IT support, marketing, HR, legal and accounting, and customer services were typically supplied by remote means by a UK associate. In addition they were not services seen as integral to the determination of the result of the gaming and fall outside functions which, under the Alderney licensing regime are required to be located in the Bailiwick. As such, operators did not have to incur considerable costs in relocating employees to Alderney or Guernsey.

For the VAT objectives to be met, it was necessary for the Alderney company to have sufficient substance in Alderney in terms of the day-to-day management and control of the business operations. It was also essential that the central support functions supplied by an associated company in the UK were restricted to support services so as not to create a fixed establishment risk.

For betting and gaming companies located in Alderney, a jurisdiction without a VAT regime, these rules coupled with the proper implementation of the arrangements, ensured that UK VAT was not charged on the majority of expenditure incurred by gaming operators in relation to central service functions. However, UK VAT was chargeable on any administrative or management services.

## **Legal Background – 1 January 2010 – 30 June 2011**

The EU VAT Directive was amended with effect from 1 January 2010. The place of supply of most services supplied to business customers became the country where the customer had established its business or where it had a fixed establishment to which the services were supplied, with relatively few

exceptions. In practice, the main effect of this change was to put any administrative or management services on the same footing as consulting, IT support and similar services, and removed the potential for any borderline disputes. The widely accepted practice of the supply of services from central functions located in the UK being received VAT-free by the operators in Alderney remained in place.

## **Legal Background – 1 July 2011 onwards**

On 1 July 2011 the EU Council Implementing Regulation (282/2011) took effect. Within the Implementing Regulations are provisions governing the place where a business is deemed to be located for VAT purposes.

A business will now be deemed to be established, for VAT purposes, where “the functions of the business’s central administration are carried out”. In order for this to be determined, it is necessary to take into account:

1. The place where essential decisions concerning the general management of the business are taken
2. The place where the registered office of the business is located, and
3. The place where management meets

In the event of any uncertainty, point 1 above is considered the most influential factor.

It should also be noted that the mere presence of a postal address may not be taken to be the place of a business establishment of a taxable person.

## **General Management**

The concept of the “essential decisions concerning the general management” is a relatively new one to EU VAT and one which has yet to be tested in the courts. It appears to refer to the operational heart of the business, apparently placing greater emphasis on day-to-day decision-making rather than where the Board meets from time to time or where strategic management decisions are taken (although these factors remain relevant).

It follows that Alderney/Guernsey businesses should re-examine the different levels of decision-making and the types of management decisions that are required to be made during day-to-day operations. It should also be remembered that the design of the arrangements may be robust but implementation less so. HMRC will always take a “substance over form” approach when reviewing such structures and look critically and how the business is conducted at the practical level.

Thus, if in practice decisions that were supposed to be taken in Alderney/Guernsey are taken in the UK for practical reasons, there could be an exposure to adverse audit. A prudent approach would be for business to ensure that NO management decisions are made outside of Alderney/Guernsey under any circumstances. This would reduce the risk of any successful challenge by HMRC.

## **Key Personnel licences**

The AGCC requires key personnel of an applicant company to satisfy a probity test. This ensures that the individual is suitable to hold a gaming licence. Persons who may be deemed to be “key personnel” include the CEO, Directors and shareholders above a certain holding of share capital, other decision makers within the company, and persons who have root level access to computer systems and/or those who are able to influence the outcome of a game or customer accounts.

It is important to distinguish the regulatory requirements of a Key Personnel licence from the statutory tests to be applied when determining the VAT treatment of services supplied to an on-line gaming operator.

In relation to VAT, the “general management” concept is wider than the criteria for when an individual requires a Key Personnel licence. For VAT purposes, each supply would need to be reviewed individually to determine whether it was received in Alderney rather than the UK or other EU Member State. This is likely to be governed in part by who took the management decision to order the relevant goods or services and where that decision was made.

The criteria for Key Personnel Licences on the other hand only cover individuals who are strategic decision makers, company share holders or personnel who have the ability to influence the outcome of a game.

## **Other UK taxes**

It should be noted that the test under the VAT regulations is different than the test applied to determining residency for UK Corporate Tax purposes (including: does the Board have sufficient expertise to control the business such that the Board has the independence to take strategic decisions; the residency of individuals sitting on the Board; and the location of Board meetings).

In addition, the test for where a business is established for UK gaming duties is different again. Remote Gaming Duty provides an objective test referring to the location of key equipment used in the playing of the game and determination of the result, whereas on line operators offering sports book (whose activities would, if found to be performed in the UK, fall within General Betting Duty) are required to consider the structure of their operations from by reference to a “basket of indicators” contained within HMRC guidance. However, this, as with the VAT position has not been tested in the Courts to date.

## **Potential VAT consequences**

An operator, who has retained certain functions of its business established in the UK (or other EU Member States), should undertake a review of its operational structure from the perspective of the new regulations. Where it is deemed that supplies of services have been received in the UK or other EU Member States and VAT is found to be chargeable, such VAT is likely to be irrecoverable representing an absolute cost to the business. In addition, the tax authorities could seek to assess VAT retrospectively and also have the power to impose interest and penalty charges.

Given that the standard rate of VAT in the UK is currently 20% such costs could be significant. Our industry experience suggests that the higher value services which would be affected include affiliate fees and charges; marketing and promotion; central support functions such as IT, Finance, HR, and accountancy and legal. However, this list is by no means exhaustive and companies would be required to consider the VAT treatment of all services received from the UK and/or other Member States.

## **HM Revenue & Customs position**

We are aware that HMRC are pursuing more in-depth enquiries into offshore operators. The budget deficit is almost certainly a contributory factor here. Indeed, they have taken the previously unprecedented step of visiting on-line gaming companies located in Gibraltar with a view to understanding the industry sector and reviewing the size and nature of resource (technical and human) located there.

To date, we are aware of only one case which has proceeded to litigation within this industry sector. HMRC determined that WagerWorks UK Ltd was supplying management services to its associated

company in Alderney which should be subject to UK VAT. In the First-Tier Tribunal, the Judge agreed with HMRC's analysis and stated that, based on the facts presented, "WWA (the Alderney entity) could not function without the services provided by WagerWorks."

It should be noted that this case relates to periods prior to 2009 and as such is based under the old VAT rules in place at that time. As the Tribunal agreed with HMRC and found that the services were of "management", VAT was due in the supplier's country (the UK). But it may only be a matter of time before there is a challenge in relation to where the operator is established for VAT purposes.

This case illustrates HMRC's increasing appetite to scrutinise and where appropriate challenge businesses within this industry sector. We are also aware of a number of other operators who have received queries from HMRC in relation to the structure of their on-line operations.

To sum up, operators who have not already done so should review the robustness of their current arrangements in light of the revised rules and HMRC's more assertive approach.

**Gavin West**  
**Director, Betting & Gaming**  
**Ernst & Young LLP**

**Tel: +44 (0) 115 954 2548**  
**Mob: +44 (0) 7976 547310**

**E-mail: [gwest@uk.ey.com](mailto:gwest@uk.ey.com)**