Betting Exchanges

Does Size Really Matter?

Julie Butler, Butler & Co, discusses the Government's commitment to review the tax position of betting exchanges and their clients

The betting industry has been the focus of a lot of media, Government and Inland Revenue attention of late.

The 2004 Budget included a commitment to review the tax position of the betting exchanges (intermediaries) and their clients. At the centre of discussions is the powerful draft Gambling Bill and recent review by the Joint Scrutiny Committee. The latter reported its findings to Parliament (the Department of Culture Media and Sport (DCMS)) earlier this year.

The Budget did mention under the section of 'Building a fairer society' the future taxation of gambling.

To read straight from HM Treasury's Budget Report 2004: 'Following consultation, the Government has decided to defer any reform of Amusement Machine Licence Duty (AMLD), and any further major reform of other gambling taxes, to align with the Gambling Bill. Examination of the future of gambling taxation will include:

- continuing work with the industry to settle a fair and equitable tax treatment for betting exchanges and their clients; and
- consideration of the appropriate tax treatment of hedged bets.'

Clearly 'betting exchange clients' means the review of the taxation of the punter is in prospect.

Industry sources said the wording of Mr Brown's announcement suggested it was the layers' tax position that will be examined most closely. So what was the industry's reception to Mr Brown's statement?

Fixed odds firms welcomed Mr Brown's comments. William Hill spokesman David Hood said: 'All that we are asking is that anyone who lays bets on an exchange should be subjected to the same regulation and taxation issue as other licensed bookmaker.' Ladbrokes also commended the move and a spokeswoman said: 'We have always maintained that layers – individuals who act as bookmakers – on exchanges enjoy an unfair tax advantage.' The Association of British Bookmakers said it was pleased that Mr Brown 'has recognised that the taxation regime relating to betting exchanges is a problem area'.

So if betting exchange layers are to be considered taxable, why not all gamblers both successful and unsuccessful? What does the industry think of this situation? Andrew Silverman, Betfair's director of public affairs, said: 'We welcome the Chancellor's announcement. Our customers do the same as customers anywhere else – they bet on outcomes of events.' However, he went on to say: 'The fact is that a tax on Betfair's punters would be inequitable and would penalise them purely for being our customers. If a tax is brought in on successful punters, it must be brought in across the board.'

Traditional bookmakers would like to see some betting exchange punters who 'lay' horses on exchanges to be licensed as bookmakers. Betting exchange layers are gambling on horses losing as opposed to winning. It has been argued for some time that the exchanges turn a gambler into a small and individual bookmaker. It is understood that the Joint Committee has recommended to the DCMS that exchange layers who operate above a certain level should be identified.

The Joint Committee 'does not accept that those using the exchanges to *lay* professionally, effectively earning a living, should be entitled to the exemption of paying tax on profits'. But it appears to have no problem with those using the exchanges to *bet* professionally, in effect earning a living. After all, off-course betting tax has been abolished.

By imposing such a threshold, it is a concern that this would surely encourage exchange punters to set up numerous exchange accounts under various guises and other named account holders, in order to give the impression that their betting has remained under any given threshold.

NOTE

As this article was sent to press the author sent us the following note:

'On Monday 14 June the Government through the DCMS response to the joint-committee recommendation. It has decided *not* to recognise the "professional punter" or the non-recreational layer. Only those people using the exchanges as "acting in the course of business" that is, those who should be registered bookmakers, will have to pay tax. All exchange layers must register.

'John Greenway who headed the committee is still concerned about the "interpretation of acting in the course of business". This saga looks set to run, for the time being the successful "pro-punter" seems to have escaped the taxation systems as have a total mass of loss claims. It is stated that to recognise the "taxable punter" would have "formidable practical difficulties identifying the professional in every appropriate case".'

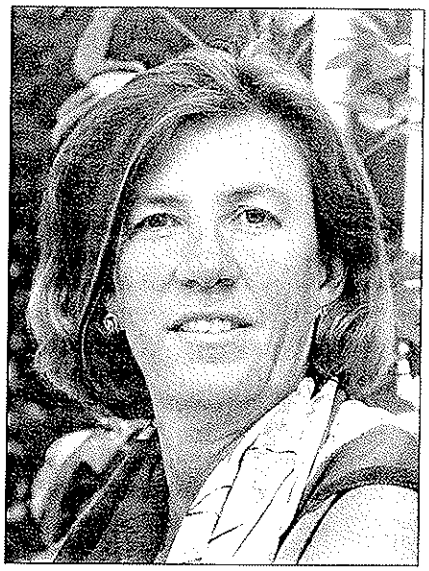
Therefore, instead of promoting transparency and integrity, the Joint Committee's recommendation of imposing a threshold would have the contrary effect of encouraging many punters to conceal their true identity. This could prove a nightmare for tax advisers.

The act of trading requires the punter both to bet and to lay large sums of money with the aim of gaining only a relatively small profit, and even this is no more than a gamble in itself. This must surely be described as nothing more than a recreational activity, and yet the 'lay' element of trading in this way would be likely to render such recreational punters liable to require a bookmaking licence or to pay a levy. The Joint Committee reported that exchanges are a good thing and that steps must be taken to avoid betting exchanges basing themselves outside the United Kingdom.

Betfair (one of the leading exchanges) wrote to every MP in the House of Commons to state the case for punters who lay horses on exchanges not to be licensed – that is, not to make their clients taxable. The exchanges involve betting on line and there is an excellent and perfect record of all transactions. The transparency enables relatively easy record-keeping and control.

So what direction will the Inland Revenue take? What impact will this have for tax practitioners, advisers and their clients (current and potential)? The current case law is set out in *Graham v Green* (1925) 9 TC 309, a case which concerned a man whose sole means of livelihood came from betting on horses at starting prices. Mr Justice Rowlatt said at page 313:

'Now we come to betting, pure and simple ... It has been settled that a bookmaker carries on a taxable vocation. What is the bookmaker's system? He knows that there are a great many people who are willing to back horses and that they will back horses with anyone who holds himself out to give reasonable odds as a bookmaker. By calculating the odds in the case of various horses over a long period of time and quoting them so that on the whole the aggregate odds are in his favour, he makes a profit. That seems to me to be organising an effort in the same way that a person organises an effort if he sets out to buy himself things with a view to secure a profit by the difference in what I may call their capital value in individual cases.



Julie Butler

'Now we come to the other side, the man who bets with the bookmaker, and that is this case. These are mere bets. Each time he puts on his money, at whatever may be the starting price. I do not think he could be said to organise his effort in the same way as the bookmaker organises his. I do not think the subject matter from his point of view is susceptible of it. In effect all he is doing is just what a man does who is a skilful player at cards, who plays every day. He plays today and he plays tomorrow and he plays the next day and he is skilful on each of the three days, more skilful on the whole than the people with whom he plays, and he wins. But I do not think that you can find, in his case, any conception arising in which his individual operations can be said to be merged in the way that particular operations are merged in the conception of a trade. I think all you can say of that man ... is that he is addicted to betting. There is no tax on a habit. I do not think "habitual" or even "systematic" fully describes what is essential in the phrase "trade, adventure, profession or vocation".'

The principle in this case was followed in *Down v Compston* (1937) 21 TC 60, where a professional golfer attached to a golf club habitually engaged in private games of golf for varying amounts and won substantial amounts. He was found not to be liable under Case II on the basis that the bets did not arise from the playing services and that there was no organisation to support the view that he was carrying on the business of betting on the games of golf. It is possible, however, that the courts might take a different view if this came to court today.

Betting by professional bookmakers is assessable even if carried on in an unlawful way (*Southern v AB* (1933) 18 TC 59). Private betting is not assessable, however habitual. Its profits, if any, are also exempt from capital gains tax (TCGA 1992, s 51(1)). Receipts from newspaper articles based on a betting system were, however, held to be assessable to income tax in *Graham v Arnott* (1941) 24 TC 157.

The racing world involves a large amount of gambling at all levels. In practice, if the Inland Revenue tried to assess the 'winners' to tax there would be a deluge of loss claims. The cautious tax practitioner should advise clients to keep a record of their winnings in case evidence is required at a later stage. The Inland Revenue always like to verify sources of income and windfalls in an enquiry situation so it is important to keep records to avoid any future problems over the identification of any capital introduced into a business. The money laundering provisions also have a large potential impact for tax advisers and their clients and illustrate the need for information on gambling activities to be provided by the taxpayer to the tax adviser.

The key issue is the proposed 'registration of non-recreational layers' on the exchanges.

For the tax adviser the betting exchanges also involve a number of serious considerations. In the broadest of terms, historically, the bookmaker has been a taxable trade or vocation. This was established in the early case of *Partridge v Mallandaine* (1986) 2 TC 179. A professional bookmaker systematically attended racecourses for the purpose of carrying on that activity; although he could not legally recover amounts due to him, he was held to be carrying on a

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vocation and was assessable under Schedule D, Case II. At the time of writing the Government are due to report back on the findings of the scrutiny committee. The smart money is on registration and taxation of the non-recreational layers. But how?

The professional gambler has always been something of an awkward problem for the Inland Revenue. In some cases it can be shown that all the badges of trade are present in what the gambler does and also a clear profit motive. There have apparently been some cases when their activity has been treated as taxable, although there are no reported cases in this area. The professional bookmaker is trading; the compulsive gambler is not. Care should be taken with the affairs of the client who is a professional gambler or who perhaps falls somewhere between these two extremes. They should be advised to keep detailed records wherever possible or at least this advice should be properly documented to protect the adviser.

If the betting exchanges were to be deemed to constitute the carrying on of a trade by the Inland Revenue would there be a multitude of loss claims submitted on tax returns?

Whilst betting exchanges, the traditional bookmakers and the Government fight out this particular issue, tax advisers must be careful to ensure that their clients are declaring all these activities and assessing each case on its merits. If the badges of trade are present, they will need to consider whether these activities should be notified as a trade and whether a disclosure should be made to the Inland Revenue.

So will size matter? Will the revised classification for bookmaker to include professional layers on the exchanges be determined by an entry level? How can tax advisers help their client base? Firstly, consider the need to make everyone aware of the Budget proposals. Secondly, consider looking at each case in anticipation of the review. Thirdly, give consideration to the thought of disclosure to the Inland Revenue of the status of the profits from the exchanges, at least in the additional information section of the return.

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