GAMBLING
PRODUCTIVITY COMMISSION INQUIRY

Further submission

On the draft report released 21st October 2009

AUSTRALIAN RACING BOARD

Overview:

This further submission responds to the draft report of the Productivity Commission's Inquiry into Australia's Gambling Industries, and in particular chapter 13 of that document.

At the outset, the Australian Racing Board places on record its appreciation that the Commission has decided to devote such a significant proportion of its Inquiry to examining the changes that have taken place in the Australian wagering market and to formulating proposals on potential future arrangements for the racing and wagering industries. This particular line of inquiry may not have been anticipated when the Commission received its reference from the Assistant Treasurer, but these are substantial matters that will have an impact on many Australians and their examination by the Australian Government's independent research and advisory body on microeconomic reform is a welcome development.

Chapter 13 of the Commission's draft report consists of a characterisation of the Australian wagering and racing industries, historically and as they exist today, which is followed by a series of draft findings and recommendations. The Australian Racing Board's further submission to the Commission, so far as it relates to chapter 13, is confined to commenting on the specific draft findings and recommendations that have been formulated by the Commission. While we do not necessarily agree with all of the interpretations or assessments that are contained in the Commission's characterisation of the Australian wagering and racing industries this further submission deliberately does not comment on these.

Draft Finding 13.1

In the absence of regulation, free-riding by wagering providers would undermine the racing industry and harm consumers of wagering and racing products. The current state-based race field legislation overcomes this problem, but poses significant risks for effective competition in wagering, potentially affecting the long-term future of racing and wagering, and, more importantly, the punters who ultimately finance both of these industries.

We support the Commission's finding that without mechanisms to prevent 'free-riding' there is a real risk to the longer-run viability of the racing industry which would have detrimental consequences for the communities where racing plays a key role. Moreover, such a decline would also adversely affect consumers of wagering and racing products.

In this respect we reaffirm our support for the concept of race fields legislation. We also reiterate our view that if the current litigation relating to the constitutional validity and application of the NSW race fields legislation either strikes down that legislation, or emasculates it, then action should be taken by the Australian Government and/ or the State and Territory Governments collectively to establish an alternative mechanism to address free riding.

We note that the draft finding that the current state-based race fields legislation "poses significant risks for effective competition in wagering" turns substantially on the concern that the legislation could be used to defend the status quo funding arrangements with TABs, or to prevent structural adjustment. In this respect we make the following observations:

- An allegation that the NSW race fields legislation is being used in such a manner is a central issue in litigation in the Federal Court. We believe that the body of evidence that will be heard by the Federal Court and the Court's determinations will materially assist in a factual assessment of the extent to which the current state-based race fields legislation poses any actual risks to effective competition in wagering.

- As the Commission itself has observed the effect of race fields legislation has been to cause a fundamental shift in the racing industry's funding model – under race fields legislation the racing authority in each state, and for each code, is paid product fees in respect of the wagering that occurs nationally on *their* product. Accordingly under the current state-based race fields legislation the market for providing racing product to wagering operators now consists of multiple suppliers (2-3 code racing authorities x 8 jurisdictions) each setting product fees independently. To an increasing extent overseas racing authorities now also supply racing product for wagering within Australia, again independently pricing their product. This constitutes a product and geographic space in which rivalry and competition take place.[1] That is to say, most Australian wagering operators accept bets on all types of races irrespective of whether they are thoroughbred, harness or greyhound races, and irrespective of which state or territory they are conducted in i.e. they are all substitutable in an economic sense. Over time if the product fee charged by one racing authority were to increase then there would likely be a move by wagering operators away from that racing authority's races and towards the races of other states and codes. Sporting competitions are another set of close substitutes in this market, and because there are little or no associated product fees with these substitutes they have a

[1] The ACCC definition of a market – see ACCC merger guidelines November 2008 p15.

significant pricing attraction for wagering operators compared with racing events. In these circumstances it can be said that rivalry amongst competitors presents as an effective constraint on any potential for racing authorities to use race fields legislation for protectionist purposes.

Draft Recommendation 13.1

The Australian Government should work with the state and territory governments to develop a national funding model for the racing industry. This model should be underpinned by national legislation and should replace state and territory based arrangements.

The key element of this model would be a single levy, universally paid on a gross revenue basis:

- *The levy should replace all other product fees currently paid by the wagering industry, but need not affect other funding channels, such as sponsorship of race meetings.*
- *The levy should be set and periodically reviewed by an independent national entity with the object of maximising long-term consumer interests.*
- *In setting the levy, the entity should engage in public consultation, and the bases for its decisions should be detailed in a public document.*

(a) Draft recommendation re national funding model

We welcome the Commission's work in developing a potential future funding model for the racing industry that addresses the issue of 'free riding' by wagering providers. We agree that instituting an unregulated free-market would be an inappropriate solution to the issue of funding the racing industry. We believe that there is substantial merit in the concept of a national funding model both as a mechanism to deal with free riding and as a means of addressing some of the distortions in the industry's existing funding model. We also agree that a legislatively-based funding model should seek to approximate the function of a competitive market.

Self-evidently achieving the requisite support to implement such a model will be affected by myriad considerations. To take but one example, if the NSW race fields legislation withstands the current challenges to its constitutional validity and its application then this will have a material bearing on the attitude of the NSW Government towards relinquishing responsibility in favour of the Australian Government.

(b) Draft recommendation re single gross revenue-based levy

As the Commission has observed a single 'price' model would have the benefits of reducing the administrative cost of the system and the compliance cost for wagering operators.

However, balanced against this, there could be said to be advantages from allowing intra-code and intercode price-based competition that would be lost under a single 'price' model. Also relevant in this regard is that in the case of the smaller centres of racing there will be no real capacity to compete by alterative means such as marketing campaigns, experimentation or innovation. If smaller centres of racing are prevented from competing on prices charged to wagering operators then they will have very limited prospects of either gaining or holding market share.

A further relevant consideration is the issue of product differentiation, product quality and pricing. For example, currently the product fee changed in respect of the Victorian Spring Carnival is higher than the fee charged for other Victorian thoroughbred races. This would seem to be to be an economically sound approach, rewarding the producer for the enhanced value of this premium product offering.

Having regard to these considerations we believe that there could be merit in a multiple 'price' model. How much merit, and whether it outweighed the associated administrative and compliance costs is something that would require close microeconomic analysis and policy discussion.

Plainly a decision to adopt a multiple rather than a single 'price' model would have consequences for other elements of the national model that is described in the Commission's draft report. For example, how would a single price-setting panel work in these circumstances where different producers of racing events wished to charge different prices.

In the circumstances we submit that the Commission's proposed national model, which at present forms part of a wide ranging inquiry into all of Australia's gambling industries, should be further examined in an inquiry specific to the racing and wagering industries. Such an inquiry would have the added advantage of much greater certainty about the constitutional and TPA issues associated with the current funding model.

An inquiry of this nature would be best be conducted by an intergovernmental taskforce given the need to coordinate national reform across existing state and territory operating models. It is suggested this taskforce be convened by the Assistant Treasurer and comprise nominated representatives of the Australian Racing Ministers Conference. In turn, the taskforce would be required to consult with the racing and wagering industries and other affected parties in the course of identifying the appropriate new national model. A focused taskforce approach is also warranted by the need to expedite reform within a rapidly evolving wagering marketplace and to address the associated racing industry funding issues.
It is apparent from the draft report that the issue of turnover or gross revenue based product fees has been carefully examined by the Commission. Even so, alternatives to the Commission's proposal of a gross revenue-based fee might still be usefully further examined. This could be undertaken in the course of an inquiry specific to racing and wagering.

(c) Draft recommendation re replacing existing product fees

While it is stating the obvious it is nevertheless important to note that existing product fee arrangements are in many cases embedded in both contractual arrangements and legislation. Accordingly there are substantial transitional issues associated with a proposal to remove existing product fee arrangements and replace them with a single product fee.

This said, even without a policy decision being made in the terms of the Commission's draft recommendation, the flow of events is likely, in time, to lead to a convergence of fees charged to wagering operators for the same product. For example, as existing commercial arrangements with TABs become open to re-negotiation via competitive licence renewal and other review processes, the TAB licence holders are likely to press for the product fee on telephone and

internet betting by corporate bookmakers and betting exchanges to become the sole fee payable by the TABs for that same activity.

For the reasons set out below we believe that TAB retail exclusivity should be continued, and as flagged by the Commission in its draft report, this should form the basis for payment of a premium on top of any standard product fee.

(d) Recommendation re national price setting panel

As per the comments in (b) above we believe that the proposal of an independent national entity setting and reviewing the product fees payable to the racing industry by wagering operators should form part of an inquiry specific to racing and wagering.

Racing product is a valuable commodity, and in principle, the creators of this value should have a substantial say in the terms and conditions of supply, including price. These matters may require closer consideration in relation to competition policy and compliance under a national pricing model.

It may be noted that the concept of a price setting panel resembles to a significant degree the function that is performed in the United Kingdom by the Horserace Betting Levy Board (**the Levy Board**). Dissatisfaction with the Levy Board model caused the UK Government to announce in 2000 its intention to abolish the Levy Board, and in 2003 it enacted legislation to enable this to be done. While this decision was subsequently reversed (largely at the behest of the local racing industry) criticisms of the Levy Board model persist. It has been retained essentially because no agreement could be reached on a better alternative.

(e) Draft recommendation re distribution

We agree with the Commission that direct distribution of product fee proceeds to the racing clubs where the betting activity takes place is not feasible.

The funding of state and territory racing industries are the subject of complex local arrangements that incorporate varying models for the payment of prizemoney and other returns to participants, racecourse infrastructure expenditure, marketing and provision of race day services. A direct distribution from wagering service providers to individual racing clubs would disrupt these well established and efficient funding arrangements. In addition, they would impose considerable administrative burden on the wagering industry.

(f) Draft recommendation re process of setting product fee

While as per (d) above we believe that the concept of a national panel is a matter that requires further inquiry, we agree with the Commission that the setting of product fees should be an open and accountable process.

Draft Recommendation 13.2

The Australian Government should request that the Australian Competition and Consumer Commission examine any adverse implications for competition associated with the ownership arrangements for Sky Channel.

No comment is offered on this draft recommendation.

Draft Findings 13.2

There are grounds for state and territory governments to cooperate when setting taxes on wagering revenue, in order to avoid destructive tax competition. However, the increased capacity for competition from lowly-taxed offshore online suppliers will, in any case, increasingly limit the capacity to tax wagering activity.

We support the proposition that destructive tax competition should be avoided by state and territory governments when setting taxes on wagering revenue. A separate issue is whether taxes should be uniform and we believe that there may be circumstances where tax rates can differ across jurisdictions for good reason. For example, the tax on totalisator wagering in South Australia will be phased out by 2012 and those funds redirected to the SA racing industry. This consideration will be the subject of separate submissions by some of the state racing authorities.

The issue of competition from lowly taxed offshore online suppliers is a real one, but we do not believe that the answer to this is to abandon the taxation of wagering. A concomitant issue is that of online suppliers basing themselves offshore to evade the payment of product fees. In both cases a proposition that taxes and product fees must be set at a level that persuades online suppliers to remain within Australia is a dismal and ultimately self-defeating one. Just as within Australia state and territory governments are currently engaged in destructive tax competition, internationally there will always be countries willing to host online suppliers in return for minimal taxes and irrespective of whether the operators are paying product fees to the racing bodies that produce the events upon which they are wagering.

The Commission has correctly identified this when it says at page 13.35 of its draft report that:

> "*Both the right to hold an Australian wagering licence, as well as the right to advertise in Australia should be contingent on paying the levy regardless of where the wagering operator is located*."

We submit that an effective mechanism to address 'free-riding' must recognise this and incorporate robust measures that target tax and product fee evasion. These measures might include:

- Financial transaction controls
- ISP blocks
- Advertising restrictions

The Australian experience with Number One Betting Shop in Vanuatu in the 1990s establishes that this can be effective. This is also the approach proposed in the new French online gambling laws described

in Annexure 1, which may be broadly described as liberalisation of the online market but with serious disincentives to deter evasion of the French arrangements.

It is worth noting that the international application of state based race fields legislation is achieving a good level of compliance from legitimate offshore wagering service providers willing to observe their approval and product fee payment obligations under Australian law.

The United Kingdom experience, set out in Annexure 2, is also relevant to consider in this context.

Draft Findings 13.3

Tote-odds betting should not be prohibited as there are better ways of dealing with the risks it involves.

The matters raised in our original submission relating to tote-odds betting remain of concern to us. We nevertheless accept that prohibition is in this instance a policy option that is unlikely to be able to be pursued, but do so on the presumption that an effective funding model can be expeditiously established to offset the potential adverse impacts of tote-odds betting.

At the same time, if tote-odds betting by a bookmaker is to be allowed to continue to expand, as the commission identifies then there may be potentially adverse reductions in the size of totalisator pools. We believe that this potential is a real one and is an issue that must be considered in connection with the question of TAB retail exclusivity.

Draft Finding 13.4

Offering inducements to wager through discounted prices is not necessarily harmful, and may primarily serve to reduce switching costs between incumbent wagering operators and new entrants. The risks for problem gamblers should be assessed and, regardless of whether prohibition or managed liberalisation is the appropriate action, a nationally consistent approach would be warranted.

We are opposed to any practices that are likely to contribute to a higher incidence of problem gambling. So far as inducements to wager are concerned we support the Commission's draft recommendation that in the first instance the attendant risks for problem gamblers should be assessed. Moreover, we agree that once that assessment has been carried out a nationally consistent approach should be taken in respect of this matter.

Draft Finding 13.5

The arguments for renewing TAB retail exclusivity are not compelling.

We do not agree with the Commission's draft finding on renewal of TAB retail exclusivity. In this respect we make the following observations:

- To frame a policy on exclusivity according to the impact of exclusive retail arrangements on outcomes for consumers would necessarily require an evidence-based assessment of what these outcomes have been and are likely to be in the future. While the submissions made to the Commission in the course of the first round of this Inquiry included several statements of opinion, no empirical evidence was submitted to the Commission that supported a conclusion that the exclusive retail provision of wagering has resulted in poor outcomes for consumers. In

this respect the Commission itself has compared takeout rates of TABs with other wagering and gambling operators, and while this is one highly significant measure of consumer outcomes, it is not the sole measure. For example it is also relevant to consider the infrastructure that enables wagering by consumers (newspaper form guides, radio and television coverage) much of it TAB funded. It is also relevant to consider that the marginal cost of production of retail and online wagering supply differ markedly, affecting the meaningfulness of a simple comparison of prices between TABs and corporate bookmakers and betting exchanges. The same point applies in respect of comparisons with the prices of other gambling products, such as EGMs, which have lower marginal cost of production, including the cost of generating the contingency (the racing event) upon which wagering is based. Finally, the Commission's comparison of takeout rates within the wagering market was, understandably in the context of the wider inquiry, a broad brush comparison rather than a detailed analysis – the material contained in Annexure 3 may assist in pointing to some of the further variables relevant to a comparison of takeout rates or prices in the wagering market. Looking to the future, the material set out below relating to the intensity of competition in the wagering market points to the conclusion that renewing TAB retail exclusivity is highly unlikely to result in materially diminished outcomes for customers.

- Whatever might have been the position in the past the Australian market for supplying wagering to bettors is today one of the intense rivalry between competitors. While retail exclusivity by definition confers a significant degree of market power on TABs it does not hermetically seal them away from the wagering market taken as a whole. The capacity of other operators such as corporate bookmakers and betting exchanges to compete for TAB retail customers is still present through such measures as:

    - marketing campaigns
    - product experimentation and innovation

  Added to this is the competition faced by the TAB retail offering from the myriad other gambling services available in casinos, hotels and clubs. This intensity of competition exists to promote good customer outcomes within an environment of continued TAB retail exclusivity.

- Totalisators of their very nature depend on scale. The Commission has described the effect of tote-odds betting on the size of totalisator pools as a potentially problematic issue. Were the size of totalisator pools to shrink significantly then this would make TAB dividends erratic and would poorly approximate the 'true odds', adversely affecting customers. In the result the Commission has not been persuaded that this is a likely outcome, but in arriving at this conclusion it draws a distinction between competition from tote-odds products and the competition that would ensue if governments were to relax the exclusivity arrangements for provision of totalisator betting. The Commission concludes that removal of totalisator exclusivity arrangements would cause severe adverse scale effects substantially reducing consumer access to reliable totalisator products. We believe that this consideration applies with even greater force to retail exclusivity. In our view retail exclusivity is essential to enable a totalisator operator to achieve the scale necessary to provide the standard of totalisator products that are currently available to Australian customers. This conclusion is given further impetus if totalisator-odds betting by bookmakers is to continue.

Chapter 13 request for feed back re credit betting

The Commission is seeking further feedback on whether credit betting should be provided to all credit providers, and if so whether the proposed restrictions are appropriate and what minimum credit threshold would strike the right balance.

We are opposed to any practices that are likely to contribute to a higher incidence of problem gambling.

We believe that if credit betting is not to be prohibited then the capacity to offer it should be extended to TABs as a matter of competitive neutrality. Moreover, credit betting should only able to be offered to large and established clients with a capacity to afford their gambling activities.

We believe that an evaluation of the impact of credit betting on problem gambling should be carried out in 2 years in conjunction with an assessment of the impact of inducements.

It may be noted that there is significant bet-back activity between corporate bookmakers and TABs throughout Australia, which in the case of TABs is hampered by their inability to offer credit. These are 'business-to-business' transactions which should not be subject to any broader credit betting prohibitions.

Draft Recommendation 12.1

The Australian Government should repeal the Interactive Gambling Act, and in consultation with state and territory governments, should initiate a process for the managed liberalisation of online gaming. The regime would mandate:

- *Strict probity standards, as for online wagering and venue-based gambling*
- *High standards of harm minimisation, including:*
    - *Prominently displayed information on account activity, as well as information on problem gambling and links to problem gambling resources*
    - *The ability to pre-commit to a certain level of gambling expenditure, with default settings applied to new accounts, and the ability to opt-out, with periodic checking of a gambler's preference to do so*
    - *The ability to self-exclude*
    - *Automated warnings of potentially harmful patterns of play.*

The Australian Government should evaluate the effectiveness of these harm minimisation measures, as well as the regulator overseeing the national regulatory regime, on an ongoing basis.

To the extent that the Commission's draft recommendation that the Interactive Gambling Act (**IGA**) should be repealed rests on its degree of success in preventing the consumption of online gaming by Australians, we believe that an essential consideration is the lack of any serious attempt to give effect to the IGA ban. That is to say, if the prohibition is assessed as not being effective then the well accepted fact that there has been failure to rigorously enforce the prohibition suggests itself a substantial explanation for this failure.

We believe that the IGA should be strengthened rather than repealed.

So far as the application of the IGA to wagering is concerned we believe that the current scope of the ban is appropriate and should be maintained. In particular, sports betting should not be unrestricted in terms of the events and contingencies on which betting can be conducted (eg micro-bets on any contingency within a sporting event such as who will make the next tackle in a rugby match, who will take the next catch or bowl the next over in a cricket game), particularly if combined with unrestricted "in-the-run" betting (currently prohibited in relation to electronic receipt of bets under the IGA) as that would raise both harm minimization issues and potential integrity and probity issues as such "micro-bets" are more susceptible to manipulation or corruption.

End.

Annexure 1

FRENCH ONLINE GAMBLING LAW

OVERVIEW

On 13th October, 2009, the French National Assembly voted in favour of the government's proposal for a new online gaming law. The amended version will now pass to the Senate, which is expected to vote on it by the end of 2009.

Previously only two operators have been able to lawfully offer online gambling – the PMU (French tote monopoly) and the FDJ (French lottery and sports betting monopoly).

Under the new legislation non-exclusive licences will be issued to any operator (French –based or foreign) wishing to offer permitted online gambling services. It is intended that in spring 2010, a new Regulatory Authority for Online Games (ARJEL) will start issuing these 5-year licences.

Permitted online gambling services are:

- Horse racing wagering
- Sports wagering
- Online poker

Casino games continue to be prohibited, as well as exchange and spread betting and "betting in the run".

PURPOSE

The objects of the legislation as set out in Article 1 are to open France to regulated online gambling consistent with the following key elements of State policy:

- Preventing gambling addiction and protecting minors;
- Ensuring the integrity, reliability and transparency of gambling activities;
- Preventing fraudulent or criminal activities undermining the ethics of sports competitions and preventing money laundering;
- Ensuring equitable and balanced development of different types of gambling to avoid destabilization of the economic sectors concerned.

LICENSING

ARJEL will report to the Minister of Budget, Public Accounts and Civil Service. Jean-François Vilotte, currently CEO of the French Tennis Federation, has been named as the head of the authority.

To obtain a licence, applicants must satisfy a number of criteria, including a requirement that they have sophisticated systems for identifying players at risk of addiction and protecting them. Operators wishing to conduct sports betting must also sign trade agreements with the organizers of sporting events, to respect the right of ownership of these.

The legislation also provides ARJEL with a set of measures to deal with operators that operate without a French licence. The organisation of unlicensed internet gambling will be punished by 3 years of imprisonment and a € 45,000 fine for each individual offence. The connection to these sites, as well as financial transactions between the illegal operators and players, will be blocked. Advertising of sites of unlicensed operators will be penalised.

TAXES & LEVIES

Licensed operators will be subject to a tax rate of 7.5% of turnover for sports and horseracing wagering and 2% of bets for poker. A portion of these revenues will be used to finance anti-problem gambling measures .

In addition to these taxes licensed operators are to pay a product fee to French racing of 8% of turnover and a 1% contribution to the funding of amateur sport .

IP RIGHTS OF SPORTS COMPETITIONS

A key feature of the legislation is that the Finance Committee of the National Assembly introduced a" property right "for the organizer of the sports event itself. This measure is intended to "preserve the integrity of sport “. "With this law, the organizer of the sporting event is recognized as the owner of the commercial exploitation that can be carried around the event." If websites want to organize bets , they must sign a contract with him ". (Government source quoted in Le Point 9/9/2009).

Annexure 2

The notion that taxes and product fees must be set in such a way as to persuade wagering operators not to relocate offshore is one that requires close examination. The United Kingdom's experience is an apposite one in this regard.

The arrangements for the taxation of wagering operators and the payment of product fees to the racing industry that currently applies in the UK came into effect in 2001-2002. The events that led to their introduction were described by one of the principal players, Sir Tristram Ricketts, a former Chief Executive of the Levy Board and of the British Horseracing Authority, as follows:

> *"Betting Tax was first introduced, in the modern era, in 1966, six years after the British Government legalised off-track cash betting, allowing betting offices to open up in the High Streets of our towns and cities. The tax was introduced at a rate of 2½% of betting turnover and was to remain a turnover tax for the next 35 years.*
>
> *The rate of tax, of course, did change over the years, as Governments saw gambling as an increasingly lucrative source of revenue. The off-track tax rate, applied to both cash and telephone betting, rose inexorably to a high of 8%. A modest reduction, to 7.75%, was made in 1992, and a further reduction was made, to 6.75%, in 1996, not long after the introduction in the UK of a National Lottery. It remained at that level until the time of the change which I shall be describing in a moment.*
>
> *Betting Tax, the proceeds of which go direct to the Government as part of the general tax revenues utilised to fund public expenditure, should not be confused with the Horserace Betting Levy, which has been payable by bookmakers to Racing since 1961, very shortly after off-track cash betting was legalised. At the time of the recent tax change, the levy too was turnover based, the differential charges amounting to an average of about 1.25% of horserace betting turnover.*
>
> *The turnover-based tax and levy, in the years prior to the change, therefore accounted for an average total charge of some 8%, although this figure was greater for the large bookmaking companies who paid a higher than average rate of levy. This combined tax and levy charge led bookmakers generally to impose a 9% "deduction" on punters to cover their tax and levy liabilities.*
>
> *Then in May 1999, an event occurred which was ultimately to lead to the radical tax change I shall be describing shortly. For it was in May 1999 that Victor Chandler International, operating from a base in Gibraltar, outside the jurisdiction of the British tax authorities, started offering "tax-free" telephone bets to UK customers, charging a "deduction" of 3%. This of course compared very favourably with the 9% "deduction" charged by British-based operators.*
> *Once Victor Chandler had broken ranks by ceasing to operate the "gentleman's agreement" that off-shore operators would not target UK customers, other bookmakers, in the face of such competition, moved their operations off-shore. The three largest companies moved to Gibraltar or Antigua, while other operators relocated to places such as Alderney in the Channel Islands and Malta. Typically, these bookmakers offered nil "deductions" over the Internet and 3% over the telephone.*
> *The impact was immediate. Telephone and Internet turnover in the UK began to decline markedly, with those bookmakers who did remain in the UK losing customers to the off-shore operators. One of these, our own Totalisator Board, reported that telephone betting turnover in the year immediately following the exodus off-shore was some 15% lower than anticipated. Government revenue was being hit; bookmakers' profits suffered; and growth in Racing's revenue via the turnover-based horserace betting levy was also damaged.*
>
> *Tax changes of all kinds in the UK are principally made in the Chancellor of the Exchequer's Annual Budget which is traditionally delivered in March. The first Budget after the mass exodus off-shore was due in March 2000 and, in the annual Budget representations from the Racing and Betting Industries, the message to Government was clear: change the tax regime to encourage off-shore operators to repatriate their business into the UK or Government, along with Racing and Betting Industry, will continue to suffer.*
>
> *On 21 March 2000, the Chancellor's announcement that he did not propose to make any changes to betting tax was greeted with widespread disappointment. But it was not all bad news. For, on the same*

day, the Government announced that it was going to consult widely on reforming betting tax to, and I quote, "enable the gambling and racing industries to flourish in the Internet age".

The resultant Government Consultation Document, appropriately titled "Our Stake in the Future", defined the objectives more precisely, and again I quote:

"The challenge of the fast-developing e-commerce environment requires a robust tax regime which creates:

- *a fair basis for UK bookmakers to compete internationally*
- *a fair opportunity for horseracing to secure financial support and*
- *a fair contribution from the betting industry towards general tax revenues".*

The Consultation Document invited comment on two key options:

- *First, a Place of Consumption Tax, providing for tax to be based on where the punter is located when the bet is placed.*

- *Secondly, a Gross Profits Tax, which, as the name clearly implies, means basing the tax charge on the gross profits of bookmakers, not their turnover.*

Option 1 was dismissed as unworkable, as the Document summarising the responses to the Consultation Document later recorded, and again I quote: "All agreed that it would be open to abuse with Government unable to exercise any control over non-compliant overseas based bookmakers. Given the pace of development of communications technology, this option was felt to be impractical and inappropriate".

Option 2, the Gross Profits Tax (or GPT as I shall refer to it from now on) attracted widespread support from the Betting Industry who, along with others, had canvassed it, as an alternative to the turnover tax, some years previously. Once it was satisfied that a GPT could be properly policed, the Racing Industry too gave it its endorsement. The Betting Industry produced lengthy papers demonstrating how, if a GPT was introduced at a sensible rate, their profitability would improve, enabling them to make a greater contribution to Racing, while Government revenues could be expected to recover, over a period of perhaps five years, to previous levels. If no change was made, even more businesses would migrate off-shore with consequent negative impact on tax revenues.

Budget Day 7 March 2001 was as much a cause to celebrate as Budget Day a year earlier had been a cause for disappointment. In the course of his Budget speech, the Chancellor of the Exchequer announced that the 35-year old tax on betting turnover would be replaced by a new tax on bookmakers' gross profits. The intensive lobbying had paid off. The case for change had been accepted.

Racing and Betting breathed a sigh of relief and rushed to congratulate the Government on a bold and radical initiative which, in the words of the responsible Minister, and I quote: "provides a better deal for punters and helps UK bookmakers to compete internationally, while continuing to make their fair contribution to Racing and to Government revenues. The reforms are fair to punters, bookmakers, Racing and the taxpayer and will provide the UK with a betting tax system and competitive environment for bookmakers for the 21st Century".

So, in March 2001 Government signalled its intention to replace, as soon as the necessary administrative arrangements could be made, a 6.75% betting turnover tax with a 15% tax on bookmakers' gross profits, defined as the difference between the stakes laid with them and the winnings they pay out. The reformed tax structure made it possible for bookmakers to absorb the tax, levy and administrative charges, and to end the 9% "deduction" charged to punters, a crucial Government pre-condition of the introduction of GPT.

The major bookmaking companies immediately repatriated their businesses to the UK, as they had undertaken to do if GPT at a sensible rate was introduced. Our Totalisator Board, who had

been considering relocating off-shore in the face of the ever increasing competition, announced that they would keep their telephone and internet betting businesses in the UK*. Some bookmakers declined to relocate and remain off-shore, including the man who started it all, Victor Chandler.* ***But the vast bulk of the horserace betting turnover is back on-shore, resulting in the creation of some 3000 new jobs****.(emphasis added)*

Total horserace betting turnover in 2002/03 is estimated to be some £7.5bn, as compared with some £5bn in 2000/01, the last full pre-GPT year.

The introduction of GPT in October 2001 was followed six months later in April 2002, by a change in the basis of the horserace betting levy from turnover to gross profits. Bookmakers are now contributing 10% of their gross profits on their British horserace betting business to the levy for the benefit of Racing.

In the last full year before the introduction of GPT, 2000/01, the horserace betting levy amounted to some £59m In 2001/02, with the benefit of a half year of GPT, the yield was some £73m. In the current year 2002/03, with the benefit of a full year's GPT, it is expected to yield some £92m, and next year, 2003/04, some £101m. As you can see, significant increases.
As of course was expected and accepted, Government's revenues, already under pressure from the exodus off-shore, fell sharply following the introduction of GPT. In Calendar 2000, the last full year of turnover tax, total revenue amounted to some £488m. The provisional figure for Calendar 2002 is some £290m.

But, as I implied earlier, Government never expected to recover all the lost ground in the short term. ***It is however secure in the knowledge that the incentives to relocate off-shore and to bet illegally have been removed****, that there has been significant job creation, which itself adds to Government revenues, that the British betting industry is well placed to attract increasing international business and the Racing Industry is better funded. Furthermore, British Gambling generally is about to benefit from a significant measure of de-regulation, which will further boost tax revenues.* (Emphasis added) "

It is against this background that one must read the 2009 statement made by former Levy Board Chairman Robert Hughes which is quoted at page 13.29 of the Commission's draft report:

> "*The irony is that the most significant increase in Levy income (one could argue that it has been the only one) was achieved when…..the basis of General Betting Duty was changed from turnover to gross profits, which was mirrored in the Levy. This eventually led to Levy income increasing by two thirds, with little effort on the part of either racing or the Levy Board (Horserace Betting Levy Board 2009)."*

It is clear that while the "*most significant increase in Levy income"* was achieved *when* the basis of betting duty was changed from turnover to gross profits, the cause and effect of the increase in Levy income had nothing to do with allowing signals of consumer preferences to be transmitted through both wagering and racing. The increase in Levy income was achieved in major part because the largest bookmakers brought their remote betting businesses back onshore, their promise of repatriating their offshore businesses to the UK being the lever they had employed to persuade the Government to reduce the applicable rates of tax.

However, to gain a complete understanding of the experience in the UK it is also necessary to look at more recent developments. In 2009, less than a decade after the taxation compact between the UK Government and the bookmakers, the two largest bookmaking companies, William Hill and Ladbrokes, announced that they would move their online betting facilities offshore. A parliamentary debate on the taxation of gambling held in November, 2009 offers this explanation for the move:

> *They have a duty to their shareholders and it has become totally unsustainable for them to keep their business here. For every £100 profit they make online, they will pay £1 or £2 in tax offshore, whereas they would pay £36 in the UK in a combination of GPT, VAT, corporation tax and horse racing levy. Clearly, it is an absolute no-brainer for them. Indeed, we should probably be grateful and surprised that William Hill and Ladbrokes have kept their online business onshore for so long….*

> *Therefore, may I suggest that the Minister speaks with bookmakers at the earliest opportunity to find a rate of tax that the Government could introduce to bring business back onshore? I suggest that would need to be around the 2 to 3 percent mark.* [2]

The Government's response to the move is encapsulated in this statement by the Parliamentary Secretary, Treasury:

> *We are disappointed by the commercial decisions of a number of major UK bookmakers earlier this year to move their internet betting operations offshore for tax purposes. However, it would be self-defeating to engage in a race to the bottom in tax rates with low-tax jurisdictions.* [3]

Understandably the British Horseracing Authority is extremely concerned by this development. As seen from the table below, by 2008 the Levy income had dropped 17% from the point referred to by Mr Hughes in the above quote as *"the most significant increase in Levy income*". Given that something more than 20% of UK bookmakers' total gross win is accounted for by remote betting[4] the relocation offshore of the online businesses of William Hills and Ladbrokes could potentially mean that the level of Levy income will drop to 2001/02 levels in one step.

The Government has commissioned the Department of Culture, Media and Sport to propose measures to remedy this situation.

Levy Yield

[2] House of Commons debate, 5th November 2009 (1098, Philip Davies conservative MP)
[3] House of Commons debate, 5th November 2009 (Sarah McCarthy-Fry, Labor MP)
[4] In 2007 the Remote Gambling Association estimated that approximately 20% of UK bookmakers' total gross win was accounted for by remote betting. Precision was not possible because not all bookmakers accounted for remote betting in the same way.

1998/99 – 2008/09

Levy Yield (£Million)	
2008/09	91.6
2007/08*	115.3
2006/07	99.2
2005/06	99.3
2004/05	105.6
2003/04	110.7
2002/03	79.9
2001/02	72.9
2000/01	60.3
1999/00	59.4
1998/99	56.0

Yield is inclusive of Tote contribution
Source: HBLB

* The 2007/08 annual report states that the 17% increase in the levy yield was a windfall "one off" telephone credit betting income.

Annexure 3

Comparing the takeout rates or prices of different wagering operators is not necessarily straightforward.

Example 1

For a price to be meaningful purchasers should, within reasonable limits, be able to purchase their desired quantity of a good or service at that price.

Below is a screen shot of a Betfair market in respect of race 2 at Rosehill on Saturday 5th December, 2009.

The market percentages are listed towards the top, with the percentage on the backers side at **102.2**%. On the same race the official Starting Price market with on-course bookmakers was **111.41%** (105.5% Top Fluctuation) and with the TAB totalisator win market at **118.82%**.

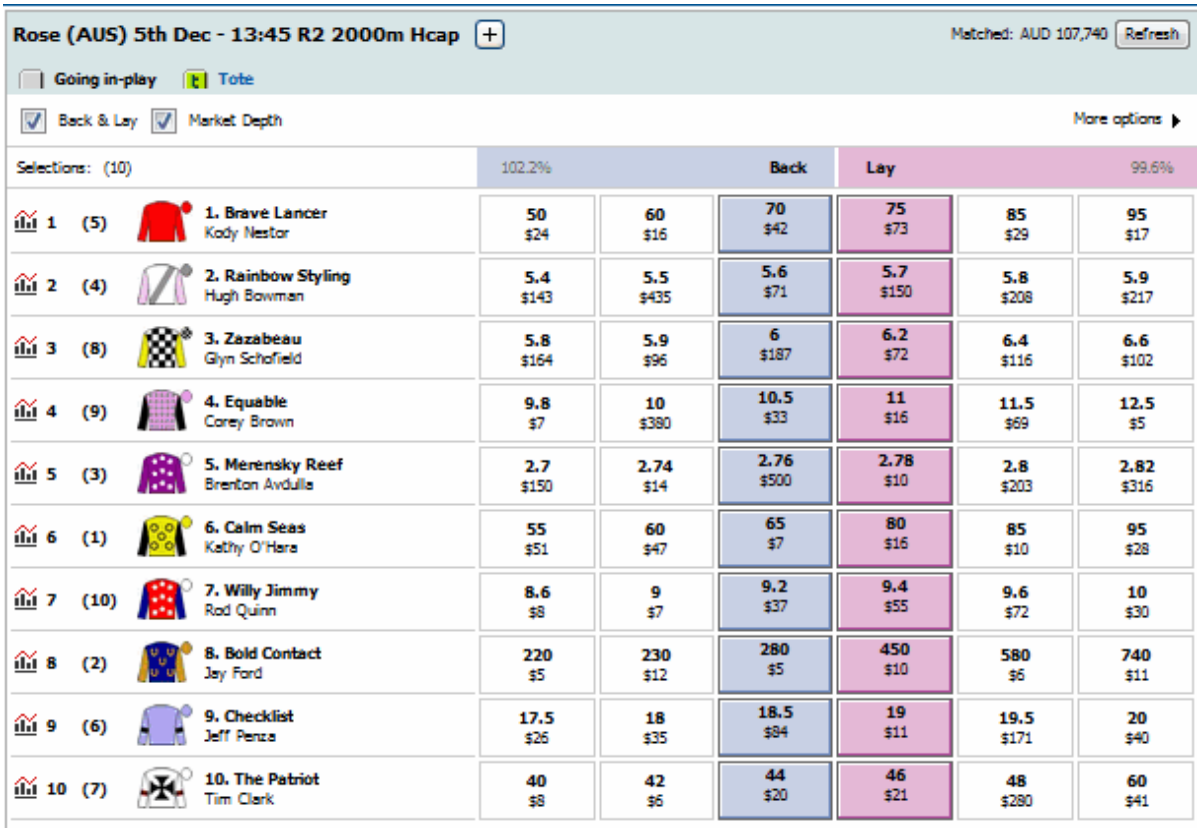
However, several additional factors need to be taken into account when comparing these prices:

- While the betting exchange market is shown as **102.2%**, this doesn't factor in the **3**- **5%** commission payable by the customer on any net winnings, whereas the margin or takeout is already factored into both the on course bookmaker market and the TAB prices.

- Betfair's percentage is set on the highest price at the time for each selection irrespective of the amount available to be bet at that price, for example, the second selection, *Rainbow Styling*, the price used for the percentage is **$5.60**, however it is limited to a stake of just **$71**. So for a consumer wishing to have a bet of **$100** or more, part of that bet will be accepted at **$5.60**, however for the remainder, the consumer must hope that there will be a matching layer or layers at that same price or risk not being able to place the bet, or alternatively accept a lower price for the remaining portion of the bet.

  This may be compared with on-course rails metropolitan bookmakers who under the NSW rules of betting are obligated to accept any bet on any price that is on their betting board, up to a liability of **$5,000**. So when their market is at **111.41%**, you can be guaranteed to get on to win up to **$5,000** on any runner, so there is a lot more depth to the market, compared to Betfair.

- the official fluctuations used to determine market percentages for on-course bookmakers are based on the common highest price of at least 3 rails bookmakers, compared to just the best available price by any bookmaker (including those not on the rail). So if one was to calculate the on-course bookmaker percentage on the best available price at any one time for all runners, the official market percentage including SP would be lower.



Rose (AUS) 5th Dec - 13:45 R2 2000m Hcap

Matched: AUD 107,740 Refresh

Going in-play | Tote

Back & Lay | Market Depth | More options

Selections: (10)	102.2%		Back	Lay		99.6%
1 (5) 1. Brave Lancer – Kody Nestor	50 $24	60 $16	70 $42	75 $73	85 $29	95 $17
2 (4) 2. Rainbow Styling – Hugh Bowman	5.4 $143	5.5 $435	5.6 $71	5.7 $150	5.8 $208	5.9 $217
3 (8) 3. Zazabeau – Glyn Schofield	5.8 $164	5.9 $96	6 $187	6.2 $72	6.4 $116	6.6 $102
4 (9) 4. Equable – Corey Brown	9.8 $7	10 $380	10.5 $33	11 $16	11.5 $69	12.5 $5
5 (3) 5. Merensky Reef – Brenton Avdulla	2.7 $150	2.74 $14	2.76 $500	2.78 $10	2.8 $203	2.82 $316
6 (1) 6. Calm Seas – Kathy O'Hara	55 $51	60 $47	65 $7	80 $16	85 $10	95 $28
7 (10) 7. Willy Jimmy – Rod Quinn	8.6 $8	9 $7	9.2 $37	9.4 $55	9.6 $72	10 $30
8 (2) 8. Bold Contact – Jay Ford	220 $5	230 $12	280 $5	450 $10	580 $6	740 $11
9 (6) 9. Checklist – Jeff Penza	17.5 $26	18 $35	18.5 $84	19 $11	19.5 $171	20 $40
10 (7) 10. The Patriot – Tim Clark	40 $8	42 $6	44 $20	46 $21	48 $280	60 $41

Example 2

Evidence has recently been given by Betfair in the Federal Court that 'back bet' customers (punters backing horses to win) received approximately 80% of their aggregate turnover back in the form of winnings. Assuming commission rates of 3% - 5%, this would seemingly mean net returns to between 75% and 77%. Potentially, these returns could be further reduced by Betfair's premium charges.

These returns to consumers can be compared with an average TAB return of 84% and the 94% return by corporate bookmakers suggested in the Commission's draft report.

Unquestionably a better rate of return is being enjoyed by those betting exchange customers that are laying runners on the exchange. However the anecdotal evidence suggests that the majority of the volume of' lay bets 'on racing is not being made by recreational punters but by professional punters and bookmakers.