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Dear Minister

**THE TAXATION OF GAMING MACHINES: CONSULTATION ON A GROSS PROFITS TAX -  
THE RANK GROUP'S RESPONSE**

I wrote to you on 16 October setting out key issues of concern for the taxation of gaming, ahead of the Pre-Budget Report. I am writing today to respond formally to the Government's consultation on the taxation of gaming machines. The Rank Group Plc ('Rank') is pleased to have the opportunity of responding to this important consultation. As requested, our response takes the form of answers to the specific questions lodged in the consultation document.

***About our business***

As you know, Rank is headquartered in the UK and is a strong contributor to the Exchequer and wider economy. At 21 October 2009, Rank Group operated 103 bingo clubs (under the Mecca Bingo brand), 87 adult gaming centres ('AGCs') and 35 casinos (mainly under the Grosvenor Casinos and G Casino brands) in the UK and the group employed 8,000 team members.

In recent years the industry has experienced considerable challenges. Against a difficult economic backdrop, our businesses have faced sudden, unheralded and substantial tax increases causing the industry to close more than 100 bingo clubs and 14 casinos; with consequential losses in jobs for employees, but with a wider impact on the communities for which these services provide an important meeting and socialising venue.

***Our views on the consultation***

At this difficult time economically, the imposition of a new taxation regime for machines, linked to gross profits, would be a further unwelcome burden. In any form, and regardless of the rate of gross profits tax ("GPT") on introduction, there will be a number of additional costs to businesses in complying with a new set of rules, **Rank's strong preference would therefore be to maintain the current system.**

If the Treasury does pursue its lead option of imposing GPT, two considerations will be vital. First the rate must be set with regard to the impact on businesses. Second, a sufficient transition period must be built in to allow the Government to work with industry to ensure the system is introduced in a way that minimises compliance costs.

In summary, Rank estimates that were a gross profits tax ('GPT') to replace Amusement Machines Licence Duty ('AML'D') and Value Added Tax ('VAT') as the system of taxation on gaming machines, **the duty would need to be set at 15% in order to achieve a revenue neutral impact on Rank.**

Furthermore, it is important to note that the tax impact of any change is elastic such that, for every percentage point above this rate of duty, Rank's tax burden increases by approximately £1m per annum.

We should note that the figures above represent a tax revenue neutral rate. It excludes the exceptional costs of any transition and the ongoing incremental administrative costs that are likely to be suffered by Rank as a result of this change, which are set out in greater detail in the responses to questions below. Therefore, there is a second 'real' revenue neutral rate for Rank that cannot at present be quantified. **Failure to take account of this 'real' rate and a rushed implementation will inevitably lead to mistrust between taxpayers and the tax authorities, uncertainty and thus unnecessary costs for all parties.**

### ***Next steps***

In calculating a tax revenue neutral rate of 15% (requested in your questions 6.8 and 6.9) we have made a number of reasonable assumptions, based on the high level description of the lead option, outlined in the consultation document. A number of further issues need clarifying before the impacts of a change can be fully assessed and a more complete calculation can be submitted. Rank feels it is essential for Government to discuss with industry, its detailed plans for implementation, and I would be happy to work with your officials to refine our calculations in light of further policy detail.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ian Burke', written over a faint, light-colored signature line.

Ian Burke  
Chief Executive  
The Rank Group Plc

## RESPONSE TO CONSULTATION QUESTIONS

### Gaming Machine Information (for operators of gaming machines)

**Questions 6.2 / 6.3** *How many gaming machines (per category) does your business own / rent / operate? Where are they located? What is the average gross profit per machine in each category?*

As at 30 June 2009 the Rank Group operated the following numbers and categories of machines:

<b>Category B1</b>	<b>(casinos)</b>	593
<b>Category B3</b>	<b>(bingo clubs and AGCs)</b>	1,059
<b>Category C</b>	<b>(bingo clubs and AGCs)</b>	3,902
<b>Category D</b>	<b>(bingo clubs and AGCs)</b>	651
<b>Total</b>		<b>6,205</b>

The exact number of machines we operate fluctuates during the year in response to customer demand and individual machine profitability; and the total is also affected by changes to the number of sites that we operate at any given time.

We are unable to publish income per category of machines. However, our total machine income (after VAT) in the year to December 2008 was £60.7m in Mecca Bingo and £28.4m in Grosvenor Casinos. The total of £89.1m represents approximately 21% of the combined revenue from those two businesses.

In the first six months of 2009, machine revenue grew by over 10% and now represents approximately 23% of aggregated revenue from Mecca Bingo and Grosvenor Casinos (excluding our two casinos in Belgium).

### Arguments for a Gross Profits Tax (for all respondents)

**Question 6.4** *Would your business welcome a move to GPT in principle? Why, or why not?*

***The Rank Group supports the principle of fair and consistent taxation regimes that do not distort the competitive environment or create a disproportionate compliance burden on taxpayers.***

It is our considered opinion that the existing tax regime should be maintained for a number of reasons, including the ones set out below:

1) We are concerned that, in a very difficult economic environment, our businesses would always be at risk of increases in the rate of GPT determined based on the wider sector rather than the specific environment of our subsector (as allowed by AMLD). Both our bingo clubs (through an increase in bingo duty from 15% to 22% in 2009) and our casinos (through a 25% increase in casino gaming duty in 2007 and a doubling of poker cash taxation in 2009) have seen severe increases in tax, with no prior consultation, in the course of recent Budgets.

One of the key barriers to investment in new machines is uncertainty of the tax treatment of the sector over a sustained period. An issue exacerbated by the withdrawal of capital allowances. We are concerned that, whatever rate was chosen initially, our businesses would be perpetually at the mercy of future changes, without prior consultation or any proper impact assessment.

2) The initial assumption behind the consultation is that GPT will be set at a rate that is revenue neutral. However, there is a significant implementation cost (the 'real' revenue neutral rate) for both the industry and government that is not factored into our GPT rate calculation in Q6.8. Moreover, the burden of

adjustment to a new system falls not only on businesses but also on the Exchequer, for whom additional costs for collecting and monitoring information would be introduced. It is therefore hard to see the economic benefits of a change at a time when the public finances are under considerable pressure.

3) Whilst the consultation document suggests that GPT would be fairer for all, in fact establishing one revenue neutral rate for all machines would actually create winners and losers in different gambling sectors. This could result in some sectors expanding and others contracting. The social impact of this, particularly on problem gambling, should be considered.

4) One of the perceived benefits for those applying for one of the 16 new “small” and “large” casinos licensed under the Gambling Act 2005 (‘2005 Act’) is that they would be permitted a higher number of gaming machines compared with existing (1968 Gaming Act) casinos.

The attractiveness of these new casinos (and hence the likelihood of local authorities being able to achieve the promised regeneration benefits) is impacted significantly by the level of taxation they are required to bear. The value of these 2005 Act casinos has already been damaged by structural changes to casino taxation in the 2007 and 2009 Budgets. Any attempt to increase the tax yield from gaming machines would undermine this area of gambling social policy as set out by the Department for Culture, Media & Sport (‘DCMS’). Furthermore, it may lead to some or all of the casinos failing to be developed and so result in a loss of revenue to Exchequer.

**Q. *Would your view change depending upon the design of the tax?***

Our preference will continue to be to maintain the status quo, but clearly there are more and less harmful approaches to introducing a change. Rank has invested a large amount of time and resources in considering its response to this paper. In doing so, several areas of uncertainty have arisen over the detail of the proposed GPT and greater clarity in these areas would be helpful. These are shown below:-

1. Our casinos and bingo clubs frequently offer promotional vouchers that may be redeemed for gaming machine tokens. Where no consideration is received, we wonder whether such bets would be ignored for the purposes of calculating the GPT (in common with bingo duty) or whether they would be subject to GPT (in common with casino gaming duty).

In addition, promotions offered by our businesses frequently involve a package of activities - for example, a meal combined with a game of bingo and a gaming machine voucher. In the past, allocation of this consideration could be derived using established VAT case law. Going forward, such receipts could be the subject of three different taxes. This risks the possibility of double taxation and non-taxation. We wonder what measures will be put in place to assist taxpayers in calculating the correct amounts of VAT, bingo duty, casino gaming duty and gaming machine duty payable under these circumstances.

2. Similarly we wonder what transitional arrangements will be implemented to ensure that no double taxation takes place on the transition from AMLD to a GPT regime. Our businesses routinely buy annual AMLD licenses, and we query whether a refund would be given to the extent that these are unused. The current AMLD regime applies a pro-rata penalty on taxpayers for cancelling AMLD licenses. We trust that any transitional arrangement would not also disadvantage those who choose to pay annually in advance, thereby supporting the government's tax receipts.

3. There is no indication of HM Treasury's intentions on the frequency of GPT returns. We note that VAT is accounted for on a quarterly basis. Whilst casino duty is also accounted for on this basis, bingo duty is accounted for monthly. The administrative burden of monthly reporting, not to mention the importance of cash-flow on many businesses, makes this an important consideration.

Monthly reporting may require more frequent collections by security companies at an increased cost. Alternatively, companies may have to invest in software capable of calculating stakes and prizes such that they can complete their GPT returns. This would introduce further costs. Rank therefore

anticipates that monthly returns would introduce third party incremental costs of compliance. Such costs could be avoided by ensuring that the proposed machine GPT, VAT and gaming duty return periods ran on the same reporting schedule.

**Therefore, Rank's preferred position is that quarterly reporting, with the flexibility incorporated in the VAT regime around non-standard quarters, should be a feature of the proposed machines GPT regime to mitigate the compliance burden.**

4. Gaming machines are frequently targeted by criminals. In the event that Rank's machines were the subject of theft, we query whether GPT would still be due on lost receipts. Until the machines are emptied, there is no verification of the amount of monies received, so assuming the crime takes place before such monies are counted, there would be confusion as to how the taxpayer should proceed.
5. We have concerns over exactly what the actual tax point will be for machine income. At present, machines are taxed effectively when they get emptied and we need this approach to continue. Were we to attempt a calculation of revenues on any other basis, it would be extremely cumbersome and prone to errors.
6. In common with many other taxpayers, Mecca Bingo Limited relies upon a third party to calculate its AMLD payments. This process is relatively easy to implement and monitor for the purposes of AMLD collection. In the event that GPT is implemented on machines, Rank would bear this additional burden of GPT compliance. This would lead to incremental administrative costs with no compensating reduction in third party fees.
7. We would also ask that accounting periods include flexibility, so that they may coincide with our own accounting cycle rather than fixed calendar periods.

These issues have arisen as a result of our review to date. They do not therefore represent an exhaustive list of issues. We believe a further period of consultation is warranted given the breadth and complexity of the changes proposed such that all of the issues outlined above (plus any other issues that may exist), can be completely explored and resolved prior to implementation.

### **Administrative burdens and compliance costs**

**Question 6.5** *If a GPT were introduced on gaming machines, would such a regime be more or less burdensome for your business? Why or why not? Do you find the current AMLD regime easy or difficult to comply with? How would this change under a GPT regime?*

The Rank Group believes that the introduction of a GPT regime would initially be more burdensome to our businesses, largely for the reasons set out in our response to questions 6.4 above 6.10 below. These factors (largely the time, cost and management resource required to effect such a change, in what are extremely difficult trading conditions) are mostly, but not wholly, transition costs related to a change in systems.

Once the new regime has bedded down, we do not anticipate that the new regime, in principle, would be notably more burdensome than the current system. However, this is assuming the new regime would be collected quarterly. If it were to be monthly, we believe that it would create more work, and therefore more cost, than the current system, including with the implications for third party arrangements and contracts set out above.

We find that compliance with the existing AMLD regime is a known quantity – our businesses and managers are comfortable and knowledgeable about requirements of them and we have long established controls in place that are implemented and well understood throughout the business. This is done in conjunction with our machine suppliers, and it is currently they who actually apply for the majority of AMLD licences on our behalf.

**Question 6.6** *Would the introduction of a GPT regime alter the structure of the industry? How would a GPT regime impact on your business? How might a GPT regime benefit your business?*

We believe that the introduction of GPT could have a negative effect on our industry, were the rate to be set higher than the 15% that we consider to be the present effective rate.

As DCMS has acknowledged, gaming machines are hugely important to the profitability of Britain's bingo clubs. Against a backdrop of the recent 47% increase in bingo duty and with the current rate of closures running at four bingo clubs per month, any further increases in taxation could have disastrous consequences for the industry and those whose livelihoods depend directly and indirectly on the industry. We believe that this in itself would undermine the social policies towards gambling as established by DCMS.

Because of the complex makeup of the industry (more like multiple sectors under one umbrella – Family Entertainment Centres, Adult Gaming Centres, Bingo Halls, Casinos etc – than a single industry), the tax burden will differ across them depending on circumstances. For some the change will be beneficial, but for many (particularly smaller operators), it will be negative. For example, those, currently below the VAT registration threshold will face a higher tax burden, whilst many will face additional complexities around recoverable and partial VAT recovery rules.

At this stage, we cannot think of any positive effects for our business that would result from the change but we are still evaluating the position. **Were GPT to be introduced at the next budget, Rank would immediately undertake a review of all supplier contracts, numbers of machines in operation, overall gaming product mix, future investment strategy and individual club profitability.**

## **VAT Treatment**

**Question 6.7** *If a GPT regime were to replace AMLD and VAT, businesses would be able to recover a smaller proportion of input VAT.*

**Q. What is your current ratio of recoverable to output VAT?**

It is not entirely clear from the drafting as to how this question should be interpreted. For the avoidance of doubt, we have interpreted it as querying the level of input VAT that we recover for every £1 of output VAT earned from gaming machines or, more simply, the current ratio of recoverable input VAT to output VAT.

Mecca Bingo Limited and Grosvenor Casinos Limited, are both members of The Rank Group's VAT return. The method of recovering VAT for The Rank Group companies is currently in the process of negotiation. However, for simplicity, we have assumed that input VAT is recovered by reference to turnover.

Whilst this is contrary to our own view of the correct method, it provides a simple proxy for the calculation requested. This calculation has proved to be exceptionally complex, not least because of the dynamic nature of this market and the uncertainty surrounding the proper methodology to adopt in light of the current negotiation.

Based on this work, we have calculated that for every £1 of output VAT accounted for in 2008 and 2009, Rank Group companies recover 40p of input VAT. **We have had our calculations independently reviewed and confirmed by Ernst and Young LLP.**

**Q. Some businesses may also become partly exempt for VAT purposes. Is your business partly exempt for VAT purposes?**

Yes.

### ***Q. What effect would VAT exemption on gaming machines have on your business?***

To ensure that we are providing the best possible customer experience we spend a considerable amount of time and money improving our machine estate through technological innovation. Becoming an increasingly VAT exempt business will increase the cost of investment because we will not be able to recover the VAT incurred on new machines.

We note that most technological innovation is driven by third-party content providers. It is possible that the additional cost of such innovation means that we must cut back on such improvements. Further, we currently lease our machines to ensure that we have the most up to date equipment in each of our premises. Again, the merits of such an arrangement must be reviewed in light of the proposed changes. Clearly, such changes are disappointing as Mecca and Grosvenor pride themselves on providing the best possible customer experience at each and every premise they operate from. However, such innovation is only possible if there is a sufficient level of return on investment.

### **Rate of GPT**

***Question 6.8 If the taxation of gaming machines was changed to a GPT basis, what would the rate of GPT have to be to leave your business no worse off, assuming the number of machines and payout rates remained the same (taking into account lower VAT recoverability)?***

We have calculated the break-even rate for the Rank Group companies (ie Mecca Bingo Limited and Grosvenor Casinos Limited) to be around 15%. We have had our calculations independently reviewed and confirmed by Ernst and Young LLP.

We should add that our calculations are based on VAT at 17.5%. Any increase in the rate of VAT would increase the amount of irrecoverable VAT and lower the GPT required to achieve neutrality. As noted elsewhere this level does not take account of non-tax costs of a switch to GPT.

### **Category D Machines**

***Question 6.9 What level of GPT for category D machines would leave your business paying the same amount of tax overall (taking into account lower VAT recovery)?***

We are unable to make this calculation as at present we make no distinction between revenue from Category C and Category D machines.

### **GPT Implementation**

***Question 6.10 If government concluded that implementation of a GPT regime was the best course of action, implementation would ordinarily follow a Budget or pre-Budget Report. How much notice would you require to prepare adequately for implementation of a GPT regime?***

The implementation of any new tax regime will always require careful planning and implementation. This is particularly when changing from a well established and well understood tax system such as VAT.

Consequently, there are a number of steps that would first need to be undertaken by our business in order to implement any changeover. The key tasks involved are detailed below:

- Re-write the existing automated interfaces that convert the gross reported machine incomes obtained from our clubs into net income and output VAT liabilities. These systems are provided by third parties and it will take time both to specify changes and amend / test the new code.
- Re-design all internal reporting processes and controls for VAT accounting and reporting.

- Design and implement new internal reporting processes and controls for GPT accounting and reporting. Whilst, this would be aided by a new machines management system that we are implementing across our estate, it will not be fully installed and running until the first half of 2010.
- Specify a one-off project plan for the tax changeover day. This would include arrangements for every gaming machine to be emptied on the last date of trading that is subjected to VAT. This would be required in order to ensure that all income is accounted for under the correct regime, but is complicated as existing machines are emptied at different times and days of the week, even within the same operating unit. Such a one-off exercise would therefore need careful consideration and would incur additional staffing costs to implement. This exercise would be even more complicated in our casinos, which are still trading at midnight on every day of the week, involving potentially significant disruption to customers.
- Assess the cash flow impact of moving from quarterly VAT payments to monthly GPT payments. This assumes that Treasury will follow existing GPT patterns and seek monthly payment.
- Identify a process to ensure that all individual machine licences expire exactly on the date of changeover. That would be extremely complicated as we use a mixture of bulk and individual licences, so we will have to identify the most cost efficient method of doing so.
- As Mecca Bingo currently out-sources the cost, control and renewal process of the AMLD licence application to its machine provider, the cost of this service is intrinsic to the supply contract and has never been separately broken out. The existing contract, which has over a year to run, would therefore have to be renegotiated. This could involve some costs and associated redundancies at the supplier end.
- Rank will have to model the impact of the change at both a Group and individual operating unit level. The Group changes will then have to be carefully explained to City analysts who, in turn, will have to amend their own business models and financial projections. This needs to be done very carefully in order to avoid an adverse impact on the Rank share price caused by a potential lack of understanding on the impact.

The operating unit model is required in order to explain the impact to local management and establish revised budgets and forecasts. This will also require discussions with our external auditors as adverse changes to profit projections could necessitate reductions in the carrying values of units or entire businesses.

- We will also have to carry out a training programme for all our club and area managers, as the change will dramatically change the structure of their club trading accounts. They will need to be able to understand why their revenue has increased and what gross profit margins they should now be expecting and why they will now incur increased costs due to irrecoverable VAT.
- Finally, we face a difficult and uncertain economic environment and the work involved above could negatively impact on our performance. Resources will have to be diverted to the activities that are otherwise required for the day-to-day management of the business.

This is a complex series of tasks that will take some time to arrange and would involve most parts of the organisation. We anticipate that we would require at least 12 months from the time of formal notification in order to ensure that the changeover is carried out in an efficient and orderly way that can be supported by HMRC and / or the Gambling Commission, if and when audited.

**Question 6.11** *If a GPT regime were adopted, who should be liable for the reformed duty?*

On balance, we believe it should be the operator, given some of the complexity of some of the issues raised here (such as promotions, thefts etc).

## **Other Issues**

**Question 6.12** *It is the Government's initial assumption that any GPT regime introduced would be based on the current definition of "gaming machine". Do you believe that this definition is appropriate? If not, how should the scope of gaming machine taxation change?*

We believe that the current definition of "gaming machine" is appropriate.

**Q.13.** *Are there any other comments regarding a potential move to gross profits tax that you feel are relevant?*

We request that there be an extended period of conversion to allow the minimum of expense and inconvenience to operators during the transition.

We believe that this proposal is a fundamental change to a key element of the gaming industry, and is not something that should be undertaken lightly or quickly. We fear that the answers we have given to some of the above questions may not be as clear or specific as Treasury may have liked, but this is because there is no single machine industry, even within the same sectors there are diverse business models.

**For The Rank Group Plc**

**21 October 2009**