Does Compliance matter?

by **Frieder Backu**

Compliance with a focus on remote gambling operations and under consideration of the different roles of involved stakeholders

The world is getting more complex for remote gaming operators. Despite the fact that the internet is a borderless medium, national regulatory frameworks differ substantially. Moreover, the legal environment is changing continuously and the development is far from being completed.

What is more, the operation of gaming websites in many cases is the result of a collaboration of a number of parties including the operator itself, third party providers for games, software, technical services, payment or white label providers.

In this article a number of aspects are examined which may be worth considering by a European gaming operator who acts cross border and offers its services to customers in Europe. There is no intention to provide a comprehensive and detailed presentation of all legal issues which can occur, rather the aim is to summarise crucial aspects in the sense of a checklist arising from experiences gained in advising operators acting in Europe.

I. General Aspects

1. Introduction

Generally speaking, compliance means conforming to applicable laws, provisions or standards. It is commonly understood in most jurisdictions that the management of a company is principally responsible for obeying applicable law. Depending on additional requirements the management can also be held liable personally in case applicable law is violated.

During the last decade the European gambling market has been subject to a number of significant changes. This applies both to the regulatory and legal environment for remote gambling operators as well as to rapid technological progress.

In a number of legal fields there has been a development towards EU wide harmonisation. Inter alia, this concerns consumer protection and data protection law or money laundering regulations.

At the same time there has been a development towards differing national gambling regimes within EU member states. Following the decision of the European Court of Justice of September 9, 2009 (C-42/07 - Liga Portuguesa) it became apparent that the principle of mutual recognition does not apply to gambling activities. As a consequence, member states continued to establish individual licensing regimes and request operators from abroad to obey national regulations. In many cases it is questionable whether these national regulations comply with the freedom of services granted under European law.

Technological progress has resulted in specialisation. Remote gambling operators frequently do not develop and provide all technology and activities by their own means. Instead they add games, technology or services of third parties to the portfolio they offer to the customer.

White label providers offer all kind of software or services which are necessary for the operation of an online-casino or sports betting site including complete turnkey-solutions.

2. Applicable Laws and Regulations

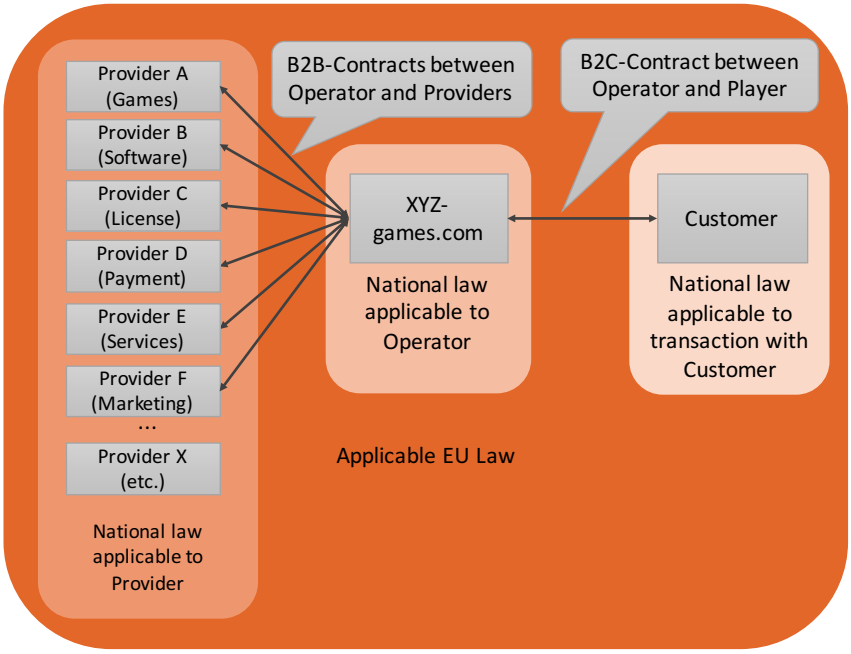
It is evident that remote gambling operators are subject to the regulations of the state where they are located including applicable corporate law, labour law, social security law, insolvency law, antitrust law, competition law, national tax law, etc.

Moreover, remote gambling operators acting cross border may also be subject to additional provisions including the following:

- regulations on a European level which directly apply and which are to be converted into national law;
- law and regulations on a national level of a state where customers or
- where contractual partners are located.

3. Variety of Involved Parties including White Label Operators

As mentioned above, the operation of a gambling site in many cases is the result of a collaboration of a number of different stakeholders. In this regard operators conclude B2B agreements with providers for software solutions, payment solutions, hotline services, content, (affiliate) marketing or hosting and other services as illustrated below:



Moreover, there exist white label providers who supply part of or even all relevant services necessary for the operation of a gambling website. Such white label providers themselves might have entered into contractual agreements with respective subcontractors.

Due to the fact that the provision of remote games in the internet is an international industry with involved parties in a variety of different states within the EU or in third countries, the legal complexity as well as the number of applicable legislations and jurisdictions is substantial. Nevertheless, it remains the obligation of the operator of a gambling site to obey applicable law. What is more, compliance with legal or tax provisions can also be crucial to contractual partners of an operator including white label operators. Furthermore, compliance as well as appropriate documentation may have substantial impact on the value of a company.

II. Compliance in specific Fields

1. Compliance with Gambling Regulations

a. State of Residence

It is obvious that an operator should comply with applicable licensing requirements of the state where this operator is located including KYC-procedures and obligations under money laundering provisions. Therefore states with a reliable and stable regulatory environment remain a favourable place for operators despite the fact that additional licensing requirements apply for the state where customers are located.

b. State of Customer

Due to the fact that a harmonised legal regime within the EU for games of chance seems unlikely within the next years, the regulatory environment of all states where customers are located remains to be assessed and considered. This means substantial additional efforts and costs for operators.

What is more, a number of European countries have implemented restrictive national laws protecting state lotteries or monopolies which may not be in line with European law. In this case the management of a remote gambling operator is forced to take a difficult decision:

Either to accept national provisions of a state which might infringe European law and the freedom of services with the consequence that only a limited range of games may be offered or customers of this state are excluded completely; or

not to obey (wholly or in part) those provisions with the risk that authorities or competitors might initiate civil, administrative or criminal proceedings against the operator and/or the management which – depending of the nature of such measures – might be enforced cross border.

In view of the importance of such decision it is crucial that this decision is taken based on reliable expert advice and that there is appropriate and sufficient documentation confirming the view of the management.

2. Taxation

a. Local Taxes

In the first place an operator is subject to taxation in the state of residence including corporate taxes and – if applicable - gambling taxes. Therefore the choice of a state with a suitable tax regime is decisive for the overall tax burden of a gaming operator.

b. B2C: Taxation of Cross Border Transactions with Customers

In general there are no international agreements for the avoidance of double taxation covering gambling taxes. At the same time a number of states have introduced point of consumption taxes for gambling activities. Therefore, transactions with customers may also be subject to taxation in the state where the customer is located. Such additional tax may result in a double taxation of one and the same transaction and therefore even have a strangling impact. Nevertheless, the operator in a first instance is liable for taxes in both involved states unless the operator

can prove that such taxation is not in line with applicable national or EU law.

c. B2C: Change of VAT regime in January 2015

Since January 1, 2015 the place of supply of electronically supplied services to private individuals is the place where that person is established and has his permanent address or where that person usually resides. Therefore remote gaming can be subject to VAT unless gambling is exempted from VAT like in many EU states. But countries like Ireland or Germany have not or not completely exempted remote gambling activities from VAT. As a consequence operators are obliged to file VAT either via national tax authorities or the MOSS system. Due to the fact that this change still is rather new a number of details still have not been clarified or decided by competent courts (including the question whether sports bets or live casinos are qualified as electronic services). As stated above the management of an operator is well advised to seek expert advice and to establish sufficient documentation confirming its view.

d. B2B: Taxation of Cross Border Transactions with Providers

Each party of a cross border transaction first of all is taxable at the place of this party's place of residence. However, cross border transactions may also be subject to limited taxation in the state of the contractual partner. This particularly applies to license fees in license agreements where a licensee may be obligated to pay withholding taxes to national tax authorities. In case of applicable agreements for the avoidance of double taxation it will have to be assessed whether and to what extent taxes under national tax law are excluded or limited (as set forth in Art. 12 of the OECD Model Tax Convention on income and on Capital). The availability of applicable double taxation agreements may have influence on the choice of preferable service providers or the place of business.

e. International Tax Law – Transfer Pricing – Dealing at Arm's Length

In many cases the operation of a gambling website is the result of a collaboration of different group companies. Generally speaking international contractual agreements between affiliated companies should be concluded tax-wise in accordance with the dealing at arm's length principle. Transfer prices should be based on an analysis of pricing in comparable transactions between unrelated parties. The appropriateness of transfer prices should be laid down in a respective documentation. Further details will be found in national transfer pricing regulations.

In general, it will have to be considered that there is a tendency on an international level to combat tax avoidance strategies or aggressive tax practices with a focus on the digital economy (like the OECD measures against base erosion and profit shifting BEPS).

f. Liability for Taxes, Enforcement of Tax Duties

Depending on additional requirements under applicable national law non-compliance with tax obligations may result in liability of an operator, its management or even involved contractual parties. Different from some other obligations under national law the enforcement of taxes on an international basis is covered by international agreements. Cooperation between tax authorities is well established within Europe. Moreover, tax liabilities may be subject to long limitation periods. Therefore, compliance with applicable tax provisions is crucial to all involved parties of a gaming operation as well as their management.

3. Data Protection

The provision of gambling services involves the processing of personal data. When gambling online, individuals regularly disclose personal information such as their names, telephone numbers, birth date and address. Furthermore gambling activities of customers including IP addresses are stored and result in detailed profiles. Where third parties are appointed for the provision of specific services (e.g. customer support, call centres, payment providers, risk assessment) they need to access customers personal data.

a. General Principle

Traditionally, the guiding principle of European data protection law sets forth that processing of personal data generally is prohibited unless it is permitted by a binding legal provision or the person whose data are processed has consented to such processing. As a consequence the transfer of personal data to third parties including data processors is only permitted if the person whose data are processed has consented to such transfer or if such transfer is obligatory for the performance of contractual obligations.

b. The new General Data Protection Regulation

The Directive 95/46/EC established a regulatory framework which seeks to strike a balance between a high level of protection for the privacy of individuals and the free movement of personal data with the European Union. EU member states were obliged to implement the Directive into national law. Therefore data protection law within the EU has been harmonised although there were differences in the interpretation and implementation of the Directive.

On April 27, 2016 the new General Data Protection Regulation (GDPR) has been adopted. It will enter into force on May 25, 2018. Different from the old Directive it does not require an implementation into national law. It constitutes the future framework for the processing of personal data. It comprises well known and new principles including the requirement of the consent of the data subject (Art. 6), the right to erasure (Art. 17), data portability (Art. 18), privacy by design (Art. 25), the obligation to notify data breaches (Art. 31), data processing by processors (Art. 28) and appointment of a data protection officer (Art. 37).

One decisive change, however, is the option to impose penalties in case of infringements of the GDPR. Art. 83 sets forth administrative fines of up to 20.000.000 € or up to 4 % of the total worldwide annual turnover of the preceding financial year, whichever is higher.

In the past data protection law for many operators and their contractual partners has been unpopular and has not been considered intensively. In future such negligence could become expensive. Therefore, operators are well advised to completely reconsider and review their data protection policies. This

also applies to agreements with third parties as data processors. In case third parties like service providers located in or outside the EU may have access to personal data it will have to be assessed in each case whether such processing is in line with the new regulation or if additional measures need to be taken. In this regard it is to be expected that in spite of the length of the new regulation a number of details still are unclear. Considering the amount of obligations included in the GDPR the transition period until May 2018 is not too long and the GDPR is to be taken seriously.

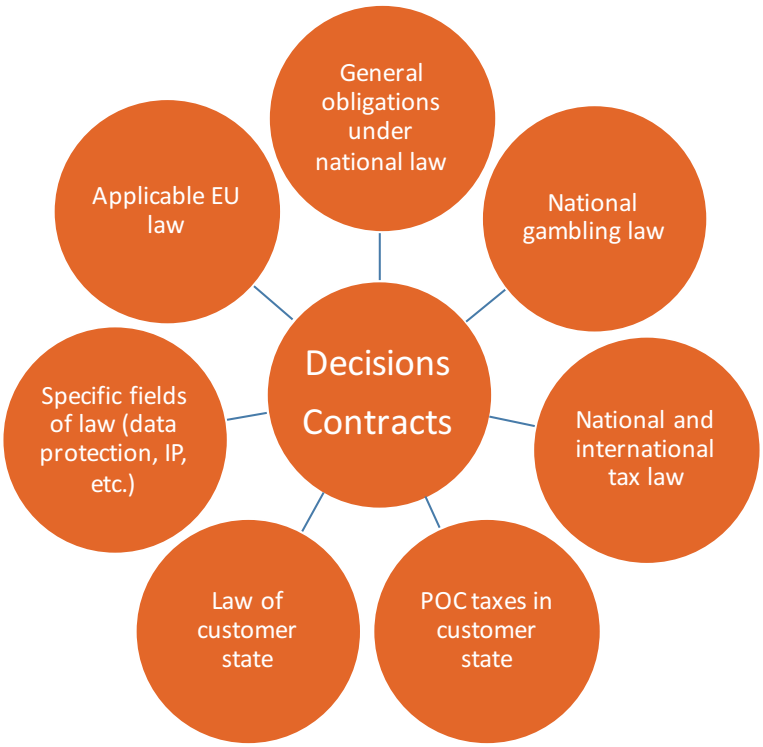
4. Service and License Agreements – IP-Rights

In the technology driven sector of remote gambling the conclusion of license agreements is essential. The more third party services or software are implemented the higher is the long term dependency on such third party providers. This means that respective agreements need to be drafted carefully and determine in detail the scope of all services to be provided, including service levels and consequences if service levels are not achieved, grant of rights to the extent that know-how, software, patents and trademarks are licensed, rights with regard to personal data which are processed as well as terms and consequences of termination with regard to IP including software and data, etc. Like in any other cross-border agreement, in addition to the scope of services and mutual obligations, general issues such as liability, warranties, duration, applicable law, place of general jurisdiction, etc. are to be addressed.

III. Summary and Conclusions

International remote gaming operators act in a complex legal and tax environment which frequently is more than one step behind the fast moving technological progress. The legal development often is influenced by political goals such as the protection of state monopolies or state owned companies. The result is uncertainty regarding applicable legal and tax provisions.

Nevertheless it remains a crucial task of the management of an operator to assess and evaluate potential risk and react accordingly. In this regard decisions should be made and contracts should be drafted under consideration and careful balancing of a variety of aspects as illustrated below.



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