

DRAFT

Report Of The Pari-Mutuel Wagering Taxation Task Force

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Foreword

The Legislative Research Commission established the Pari-Mutuel Wagering Taxation Task Force during the 2021 Interim to:

- study the taxes and rates related to horse racing as found in KRS Chapter 138,
- study the impact that changing the rates would have on the horse racing industry and the economy of Kentucky,
- study the funds relating to the horse industry in Kentucky to which the historical horse racing tax receipts are allocated, and
- determine if any changes should be made to the current system.

The task force received testimony from various individuals and associations affiliated with the horse industry in Kentucky. This report summarizes the testimony received by the Pari-Mutuel Wagering Taxation Task Force and represents the final action taken by the task force.

The Co-Chairs wish to thank the members of the task force and all those who assisted in studying and informing the task force members on this topic.

Jay D. Hartz
Director

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Summary

The Legislative Research Commission developed the Pari-Mutuel Wagering Taxation Task Force to study the taxes and rates related to the horse racing industry, the impact that changing rates would have upon that industry, the various distributions of the pari-mutuel tax receipts to funds relating to the horse industry, and to recommend any changes needed to the current structure.

The ten-member Task Force held five public meetings beginning on July 16, 2021. Various officials and entities within the horse industry gave testimony and information to assist task force members in answering questions they had on the issues facing the task force.

At its meeting on November 19, 2021, the task force adopted this report detailing the findings which were made based on the information presented to the members. The findings are consolidated into topics related to:

- an overview of taxes paid by the horse racing industry and the pari-mutuel wagering tax,
- the horse industry in Kentucky,
- analysis of historical horse racing taxes and elasticity of the pari-mutuel wagering tax, and
- the equine education programs at universities throughout the Commonwealth.

Chapter 1

Overview of Taxes Paid By the Horse Racing Industry

In addition to paying the same taxes as any other businesses operating in Kentucky, including income tax on net income, property tax on real and tangible personal property, and sales tax on the consumption of tangible personal property or certain services, race tracks which conduct licensed horse racing in Kentucky are required to pay three additional fees or taxes. These fees and taxes include a license fee, the race track admission tax, and the pari-mutuel tax. The Legislative Research Commission from the Appropriations and Revenue Committee and the Legislative Economic Analysis Office worked in coordination with the Kentucky Horse Racing Commission to outline the various taxes paid by the horse racing industry which were presented to the task force at their first meeting.

As a licensed industry in Kentucky, race tracks are required to pay a license fee. The license fee charged to Kentucky race tracks varies from track to track based on the average daily mutuel handle. The term “daily mutuel handle” is statutorily defined as the total gross amount of money bet or wagered by a race track’s patrons by means of pari-mutuel, combination, or French pools on live races conducted by the track. The amount of the fee increases incrementally as the average daily mutuel handle increases. Since fiscal year 2016-2017, the annual receipts from the license fee on Kentucky race tracks has averaged approximately \$260,000. These receipts to the Commonwealth are deposited into Kentucky’s General Fund.

Licensed Kentucky race tracks are also required to collect and pay an admission tax of fifteen cents (\$0.15) for each person that enters the grounds or enclosure of any race track at which a live race meeting is being conducted. Race tracks which charge admission to patrons attending the race meeting are able to pass the admission tax on to their patrons. However, some race tracks today do not charge an admission fee to patrons entering the race track. KRS 138.480 requires the race track to pay the admission tax on both paid and free admissions. Those tracks not charging an admission fee typically estimate the number of patrons at their facility during a given race meeting and pay the admission tax based on that estimate. The admission tax is to be paid by each race track within 30 days after each race meeting. Prior to fiscal years 2019-2020 and 2020-2021 which were impacted by COVID-19, the revenue collected from the admission tax surpassed \$200,000 a year, with all revenue being deposited into the General Fund.

By far the largest tax on licensed Kentucky race tracks is the pari-mutuel tax. This tax is collected based on varying percentages applied to the taxable base of all money wagered on live racing, historical horse racing, and intertrack and simulcast racing. Race tracks are required to submit weekly reports, as well as weekly payments of the tax, no later than the fifth business day following the close of each week of racing.

The pari-mutuel tax also applies to advance deposit account wagering. As licensed taxpayers, these companies, which maintain electronic accounts upon which wagers are made by Kentucky residents, are required to report and pay the pari-mutuel tax. These taxpayers are not race tracks, but may be affiliated with a race track in Kentucky.

The amount of revenue collected from the pari-mutuel tax has grown substantially since fiscal year 2016-2017, from \$6.8 million to \$31.2 million in fiscal year 2020-2021, an approximate increase of 360 percent. The total receipts generated from the pari-mutuel tax are distributed to a variety of funds throughout the state, which are then used by the horse industry, state universities, and the Commonwealth’s General Fund. Table 1.1 outlines the three additional fees and taxes paid by these licensed taxpayers in Kentucky.

Table 1.1
Additional Fees and Taxes Paid by Race Tracks

License Fee KRS 137.170	Admission Tax KRS 138.480	Pari-Mutuel Tax KRS 138.510 et seq.
Who: Every person engaged in the business of conducting a race meeting at which live horse races are run for stakes, purses, or prizes, under the jurisdiction of the Kentucky Horse Racing Commission	Who: Each person entering the grounds of any race track at which a live race meeting is being conducted under the jurisdiction of the Kentucky Horse Racing Commission	Who: Any person conducting pari-mutuel wagering on: <ul style="list-style-type: none"> • Live racing • Historical horse races • Intertrack and simulcast racing • Advance deposit wagering
What: A license fee based on the track’s average daily mutuel handle for each day of racing: \$0-\$25,000\$0 \$25,001-\$250,000\$175 \$250,001-\$450,000\$500 \$450,001-\$700,000\$1,000 \$700,001-\$800,000\$1,500 \$800,001-\$900,000\$2,000 \$900,001 and above\$2,500	What: A tax of fifteen cents (\$0.15) for each day	What: An excise tax with varying rates: <ul style="list-style-type: none"> • Live racing – 3.5% or 1.5% • Historical horse races – 1.5% • Intertrack and simulcast racing – 3% • Advance deposit wagering – 0.5%
When: Tentative report and payment filed 30 days following the close of each duly licensed race meeting Final report due on or before December 31	When: Collected by the race track from each person and paid to the state within 30 days after the end of each race meeting	When: Weekly report and payment of tax, no later than the 5 th business day following the close of each week of racing during the race meeting

Overview of the Pari-Mutuel Tax

The pari-mutuel tax is levied on all money wagered via pari-mutuel wagers on live racing, historical horse racing, intertrack and simulcast racing, and advance deposit account wagering. The percentages of tax applied to these wagers varies based on the type of wager that is made, as follows:

- Live racing – 3.5% or 1.5%
 - 3.5% applies to each track with a daily average live handle of \$1.2 million or above; and
 - 1.5% applies to each track with a daily average live handle under \$1.2 million
- Historical horse racing – 1.5%
- Intertrack and simulcast racing – 3%
- Advance deposit wagering – 0.5%

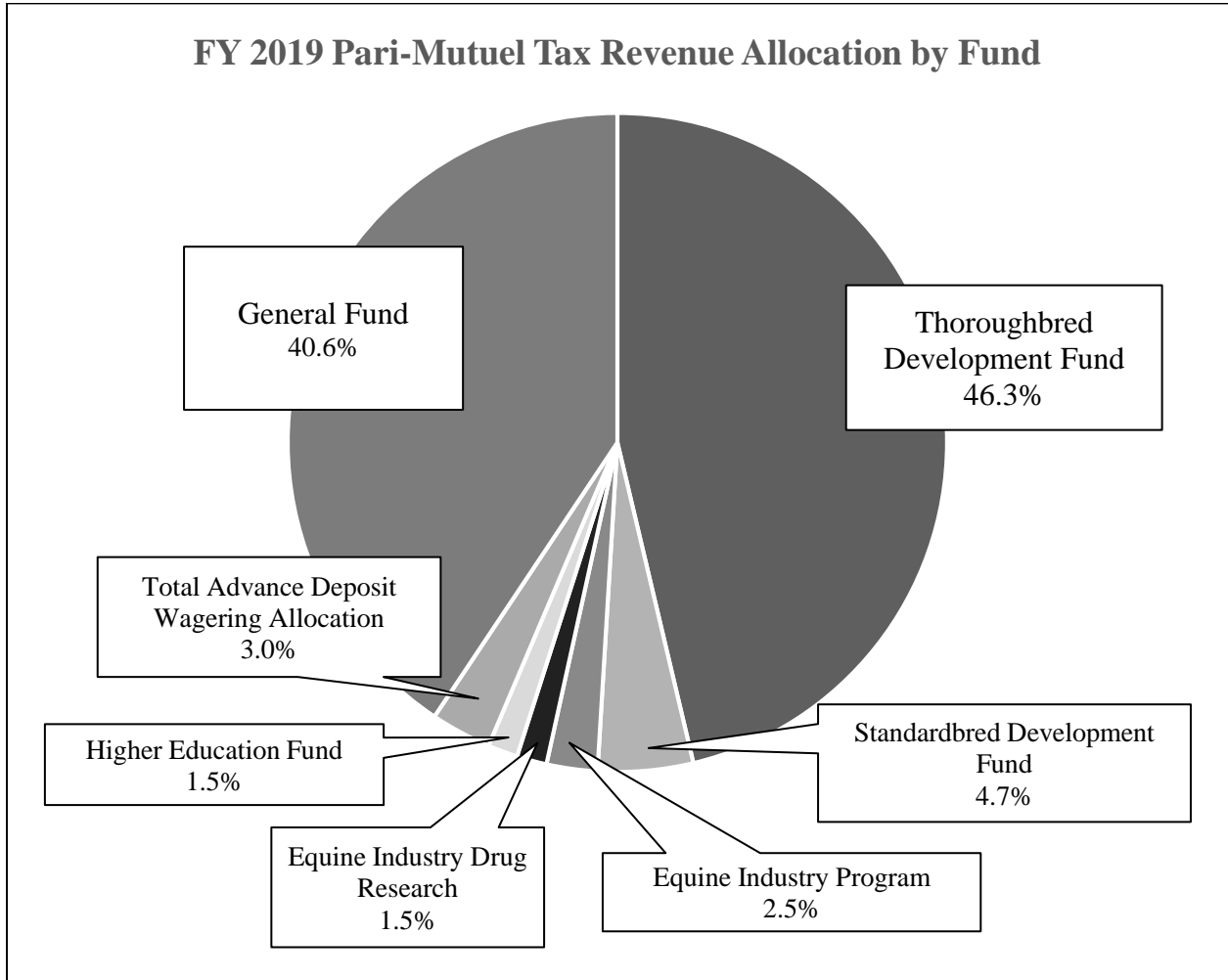
The revenue collected from the pari-mutuel tax is distributed to various funds. Three of these funds provide moneys to benefit the horse industry in Kentucky. These funds are the Thoroughbred Development Fund, the Standardbred Development Fund, and the Kentucky Quarter Horse, Paint Horse, Appaloosa, and Arabian Development Fund. Distributions to these funds are based on a percentage of all money wagered on live races and historical horse races at tracks specifically racing that breed of horse. These moneys may be used for various purposes, including the promotion, enhancement, improvement, and encouragement of breed development, purse supplements, and improving the overall quality of racing.

In addition to the three development funds, distributions are also made to postsecondary educational programs which focus on the equine industry. The Equine Industry Fund is established for use by the University of Louisville's Equine Industry Program, the only equine program in Kentucky mandated by statute. The Higher Education Equine Fund also receives funds from the pari-mutuel tax and is managed by the Kentucky Council on Postsecondary Education. This fund assists the other equine programs at state universities throughout Kentucky and is restricted to capital purchases and teaching infrastructure.

Moneys from the pari-mutuel tax are also distributed to the Equine Drug Research Council, which funds research and suggests medication policies for racehorses competing in Kentucky.

In 2019, 40.6 percent of the revenue generated from pari-mutuel wagering was deposited into the General Fund. However, the largest portion of revenue generated from the pari-mutuel tax was deposited into the Thoroughbred Development Fund, which received 46.3 percent of the revenue generated for that fiscal year. The other allocations make up the rest of the 13.1 percent of contributions, with none of these other funds receiving more than 5 percent each of the total revenue generated in 2019. Table 1.2 contains a pie chart depicting the FY 2018-2019 distributions.

**Table 1.2
FY 2019 Pari-Mutuel Tax Revenue Allocations**



Source: June 2019 Pari-Mutuel Wagering Report by the Kentucky Horse Racing Commission

Pari-Mutuel Tax Distribution: Live Race Wagering

According to KRS 138.510, live racing wagers are taxed at either 3.5 or 1.5 percent of all money wagered. Race tracks which have a daily average live handle of \$1.2 million or more are taxed at the 3.5 percent rate, while those with a daily average handle under \$1.2 million are taxed at the 1.5 percent rate. However, no race track in Kentucky has had a daily average live handle of \$1.2 million or more since fiscal year 2007-2008.

For receipts from Thoroughbred race tracks, 0.75 percent of all money wagered is deposited into the Thoroughbred Development Fund, 0.20 percent is deposited into the Equine Industry Fund, 0.10 percent is deposited into the Higher Education Equine Fund, and 0.10 percent is deposited into the Equine Drug Testing Fund. For receipts from Standardbred race tracks, the same distributions are made to the various funds, except that 1.00 percent of all money wagered is

deposited into the Standardbred Development Fund instead of the 0.75 percent that is deposited into the Thoroughbred Development Fund. Table 1.3 outlines these percentages by type of fund.

Table 1.3
Percentage Distributions from Live Wagers

Live Wagers		
Type of Race Track	Thoroughbred	Standardbred
Pari-mutuel Tax (Percent of Handle)	1.5%	1.5%
Development Funds	0.75%	1.00%
Equine Industry Fund	0.20%	0.20%
Higher Education Equine Fund	0.10%	0.10%
Equine Drug Testing Fund	0.10%	0.10%
Net Pari-mutuel Tax To General Fund	0.35%	0.10%

Source: KRS 138.510(1)(a), (b), (c), (d), and (e)

In total, 0.3 percent of the total handle from pari-mutuel wagers on live racing are distributed to postsecondary equine education programs, with 0.2 percent being distributed to the Equine Industry Fund and 0.1 percent to the Higher Education Equine Fund. With an additional 0.1 percent of revenue being distributed to the Equine Drug Testing Fund, the remaining revenue of 0.35 percent of total handles from wagers at a Thoroughbred race track and 0.1 percent from wagers at a Standardbred race track is deposited into the General Fund. Revenue generated from wagers on live racing made up 5.5 percent of the total pari-mutuel wagering in fiscal year 2019. On average, a typical two dollar wager placed on a live race will return \$1.61 to the public in winnings with \$0.34 going back to the host race track in net commission.

Pari-Mutuel Tax Distribution: Historical Horse Racing

Historical horse racing is the largest revenue generator from among the various pari-mutuel taxes. The tax rate on historical horse racing wagers is 1.5 percent of all money wagered. The various funds which receive distributions from live racing also receive funds generated from historical horse racing at the same percentages as live racing wagers. However, the Equine Industry Fund is capped at receiving \$650,000 each year, and both the Higher Education Equine Fund and the Equine Drug Testing Fund are capped at \$320,000 a year. Table 1.4 depicts the percentages at which distributions are made from the historical horse race wagers.

Table 1.4
Percentage Distributions from Historical Horse Race Wagers

	Historical Horse Race Wagers	
Amount Of Daily Average Live Handle	Tax Rate Doesn't Vary With Handle	
Type of Race Track	Thoroughbred	Standardbred
Pari-Mutuel Tax (Percent of Handle)	1.5%	1.5%
Development Funds	0.75%	1.00%
Equine Industry Fund	0.20%	0.20%
Higher Education Equine Fund	0.10%	0.10%
Equine Drug Testing Fund	0.10%	0.10%

Source: KRS 138.510(1)(a), (b), (c), (d), and (e)

In fiscal year 2019, historical horse racing generated 81.6 percent of the total revenue generated by the pari-mutuel taxes. On average, a typical two dollar wager on a historical horse race will return \$1.83 to the public which leaves \$0.14 being collected by the host track in net commission.

Pari-Mutuel Tax Distribution: Intertrack and Simulcast Wagers

Intertrack and simulcast wagers are taxed at a rate of 3 percent of all money wagered. The Thoroughbred and Standardbred Development Fund each receive 2 percent of the total handle from intertrack and simulcast wagers based on the breed upon which wagers are made. The postsecondary equine education programs receive 0.15 percent of the total handle, with Equine Industry Fund receiving 0.05 percent of total handle and the Higher Education Equine Fund receiving 0.1 percent. The Equine Drug Testing Fund receives 0.1 percent, and 0.75 percent of all money wagered is deposited into the General Fund. Table 1.5 outlines these distributions.

Table 1.5
Percentage Distributions from Intertrack and Simulcast Wagers

Type of Race Track	Thoroughbred Race Tracks
Pari-Mutuel Tax Rate (Percent of Handle)	3.00%
Development Fund	2.00%
Equine Industry Fund	0.05%
Higher Education Equine Fund	0.10%
Equine Drug Testing Fund	0.10%
Net Pari-Mutuel Tax Deposited in General Fund	0.75%

Source: KRS 138.510(2), KRS 230.752, KRS 230.750

Revenue generated from intertrack and simulcast wagers made up 9.5 percent of the total pari-mutuel tax revenue generated in fiscal year 2019. On average, a typical two dollar bet via simulcast at a thoroughbred track returns \$1.58 to the public with \$0.34 being collected by the host track in net commission.

Pari-Mutuel Tax Distribution: Advance Deposit Account Wagering

Advance deposit account wagers are taxed at 0.5 percent of the all amounts wagered through the licensee by Kentucky residents. For wagers on Kentucky races, 85 percent of the tax revenue generated is distributed to the horse association which conducts the race. For wagers on races outside of Kentucky, 85 percent of the revenue generated is distributed to the host track through which the patron wagers or the track that is within 25 miles of the patron when the wager is made.

One-half of the revenue received by an association or host track must be distributed to its purse account. The General Fund receives 15 percent of the total revenue generated from advance deposit account wagering. Table 1.6 describes this distribution.

Table 1.6
Percentage Distributions from Advance Deposit Account Wagering

Advance Deposit Account Wagering	Tax Rate Doesn't Vary by Race Type or Handle Amount
Pari-Mutuel Tax (Percent of Handle) (KRS 138.513)	0.50%
Wager on a KY race (Distributed to association conducting race)	85% (0.425% of Handle)
Wager on non-KY race (Distributed to Host track)	85% (0.425% of Handle)
Net Tax Deposited in General Fund	15% (0.075% of Handle)

Source: KRS 138.530(3)(e)(1) and (2)

Of the four types of pari-mutuel wagers, advance deposit wagering made up the lowest percentage of the total revenue from pari-mutuel taxes collected in 2019 at 3.4 percent. On average, a typical two dollar wager on an advance deposit account returns \$1.56 to the public while \$0.39 is collected in net commission.

Chapter 2

State of the Horse Industry in Kentucky

On August 9, 2021, the Kentucky Equine Education Project presented information at the second meeting of the task force related to the strengthening of the horse industry, and how it will ultimately lead to job creation and economic growth throughout Kentucky. Overall, the horse industry in Kentucky is growing substantially and remains one of the signature industries within the state. Much of the recent success within the industry can be attributed to the passage of Senate Bill 120 of the 2021 Regular Session, which protected historical horse racing and paved the way for significant investment into the horse industry.

With a \$6.5 billion total economic impact, Kentucky's horse industry has given a substantial economic boost to the state. The equine industry also provides nearly 80,000 jobs within the Commonwealth. These jobs range within a wide variety of job sectors, which contribute to various Kentucky communities and not just those with horse racing facilities or horse farms. One horse contributes to a variety of particular jobs in a wide range of industries.

Horse racing plays a key role in Kentucky's tourism industry. Participants and spectators spend \$233 million annually on traveling, dining, and lodging which can be tied to equine events throughout the state. Aside from equine events, recreation also brings in substantial revenue and creates a significant amount of jobs. Recreation attributed to the horse industry brings in \$209 million in direct value to Kentucky's economy. Almost 6,000 jobs can be attributed to the horse industry from recreational activities in the Commonwealth. A major aspect of the horse industry which contributes to the recreation sector comes from trail riding, with nearly one-half of all trail riders coming to Kentucky from out of state.

A bright future is anticipated for Kentucky's horse industry, with 30.5 percent of households having a horse enthusiast in the family. Minors make up 38 percent of horse enthusiasts within Kentucky, which is much higher than the national average of 23 percent. Another bright spot that factors into Kentucky's future are the 10 postsecondary institutions and technical training programs that offer equine education in Kentucky. Nearly 80 percent of graduates of these institutions and programs stay in Kentucky, even though these students come from all over the world.

Table 2.1
Postsecondary and Technical Equine Training Programs

Asbury University	Morehead State University
Bluegrass Community and Technical College	Murray State University
Georgetown College	University of Kentucky
Kentucky Horseshoeing School	University of Louisville
Midway University	Western Kentucky University

State of the Standardbred Industry in Kentucky

In addition to their report on the state of the horse industry as a whole, the Kentucky Equine Education Program gave additional insight into Kentucky's Standardbred industry. Historical horse racing has contributed to a rejuvenation of the Standardbred industry in Kentucky. The Kentucky Standardbred Development Fund provides purse money for Standardbred races which is contributed through pari-mutuel taxes on moneys wagered at Standardbred races, including historical horse racing. Prior to the advent of historical horse racing, the Kentucky Standardbred Development Fund paid out less than \$100,000 in annual purse supplements. However in 2019, the Kentucky Standardbred Development Fund paid out \$1,716,556 in purse supplements for Standardbred races.

Prior to the growth of historical horse racing, two Standardbred tracks, Thunder Ridge Raceway and Players Bluegrass Downs, both closed. Since the growth of historical horse racing has provided larger purses for Standardbred racing, two new Standardbred tracks will be opening soon; namely, Oak Grove and a track in Corbin. In Corbin, this new track will add an anticipated 200 to 250 full-time jobs, with 300 to 400 seasonal jobs during the race season. The track in Oak Grove is a \$200 million project that will add approximately 350 jobs, which are mostly full-time positions.

Thanks to this growth, Standardbred purses have nearly tripled. This has allowed for Standardbred programs to find success, such as the Kentucky Sire Stakes, which has had participation grow five times higher than in 2014. The Kentucky Proud Series Fair Program was on the verge of failure prior to historical horse racing. This program paid out over \$540,000 in purses in 2020 and over \$780,000 in 2021. Ultimately, Kentucky is poised to soon become one of the national leaders in the Standardbred industry, with historical horse racing being a major reason for this success.

State of the Thoroughbred Industry in Kentucky

Even with the challenges of the COVID-19 pandemic, Kentucky's Thoroughbred industry has been able to remain competitive on a national level, thanks to the favorable market conditions within the state. This success has allowed Kentucky to remain the largest producer of Thoroughbred horses in the United States, as well as a net exporter of Thoroughbreds throughout the world. Kentucky's Thoroughbred foal crop has remained fairly stable over nearly the last two decades. This goes against the national trend which has seen a substantial decline throughout the United States and most of the major horse producing states. At the second meeting of the task force, the Kentucky Thoroughbred Association presented information on the state of the Thoroughbred industry in Kentucky.

One of the major reasons for success of the Thoroughbred industry in Kentucky is attributed to an increase in purses for Kentucky races. Kentucky has recently become the national leader in the amount of average purse per race, which has helped to attract more horsemen to the state on a long-term basis. Increases in purses also attract larger fields for races. Larger fields for races leads to more money being wagered. More money being wagered means larger revenues for the general fund and the various development funds by way of the pari-mutuel tax.

Similar to the Standardbred industry, increases in wagering on historical horse racing has contributed significantly to higher purses and to the Thoroughbred industry in general. Higher purses have led to a significant increase in registrations in horses of racing age within Kentucky since 2003. Kentucky also has the highest average field size in the nation, along with being only one of three major horse racing states to have increased or maintained their average field size since 2012.

Table 2.2
A Comparison of Average Field – 2012 Compared With 2019 and 2020

	Kentucky	New York	Florida	Maryland	California	Indiana
2012	8.8	7.7	8.2	7.9	7.5	8.4
2019	8.7	7.3	8.1	7.7	6.9	7.9
2020	8.8	7.9	8.4	6.7	7.2	7.9

Source: Kentucky Thoroughbred Association

Increases in average purses and average field size are in large part fueled by increased supplements from the Kentucky Thoroughbred Development Fund supplements. In 2020, the Kentucky Thoroughbred Development Fund paid out \$17.5 million to support Thoroughbred racing. This is a substantial increase from 2012 in which the fund contributed \$6 million.

Kentucky’s strong Thoroughbred industry helps to attract and maintain a variety of high paying jobs within the state. Some of these include veterinarians, operations managers, agricultural managers and workers, and animal scientists and breeders. Many major owners and trainers throughout the world are operating satellite facilities within Kentucky. These horsemen are buying homes and farms throughout Kentucky, while also establishing principal places of operations and training centers. High wage workers from horse racing as well as the large-scale horse racing entities which have come to Kentucky make significant contributions to Kentucky’s economy and the general fund through a combination of the sales, income, and property taxes.

Overall, many factors impact Kentucky’s ability to maintain its position among the top states for Thoroughbred production and Thoroughbred racing. Most importantly, Kentucky’s position can be attributed to the successful business environment which has been created through public policy achievements and a favorable tax structure. At one time Kentucky was at a competitive disadvantage throughout the nation; now, thanks to advancements in Historical Horse Racing and the creation and success of the Kentucky Thoroughbred Development Fund, Kentucky is poised to maintain its rich history of Thoroughbred breeding and racing and remain as one of the global leaders in the horse industry.

Future Capital Investments at Kentucky’s Tracks

Over the last five years, there has been approximately \$1.5 billion dollars in investments at Kentucky horse tracks and facilities, with every market and facility experiencing growth. These investments have been made throughout Kentucky, contributing to job growth throughout the state and state revenue growth due to increasing tax revenues.

Table 2.3
Investments in Kentucky Race Tracks

Kentucky Downs	\$400 M
Churchill Downs	275 M
Oak Grove	219 M
Derby City	151 M
Turfway Park	150 M
Cumberland Mint	82 M
Keeneland	72 M
Red Mile	58 M
Ellis Park	29 M
Newport Gaming	27 M

Source: Keeneland Association

Also, the demand for stalls within Kentucky is at an all-time high. This increase in demand is related to the increasing amount of purses which attract horsemen to race in Kentucky. Since 2018, purses have grown substantially.

As historical horse racing facilities continue to grow, they will have substantial impacts on Kentucky job growth and the Commonwealth's economy. On average, each historical horse racing facility in Kentucky employs between 220 and 280 full-time employees. Leaders from two of Kentucky's biggest racetracks, Churchill Downs and Keeneland presented information at the third meeting of the task force on current and future investments at Kentucky's tracks. These leaders suggest that if they are allowed to keep the current structures of taxation and regulation, the industry will continue to grow, which will ultimately lead to further demand within the industry and economic benefits to Kentucky as a whole.

Chapter 3

Analysis of Historical Horse Racing Taxes

Effective Tax Rates

According to the Kentucky Horse Racing Commission reports from fiscal year 2020-2021, moneys wagered on historical horse racing are categorized in three ways. The largest amount is the payout which is given back to the individuals making the wager on historical horse races, averaging approximately 91.1% of total handle. The second largest amount is the net commission which is maintained by the owner of the facility at which the wager is made, averaging 7.2% of total handle. Lastly, 1.5% of total handle is taxed by the pari-mutuel tax. The Kentucky Horse Racing Commission estimates that 0.2% of total handle makes up the amount lost in breakage and change in pools.

Of the 1.5% of the total handle representing the portion of the wager taxed, 0.67% of the total handle is deposited into the General Fund. The remaining 0.83% of the total handle is distributed to various horse racing industry funds in the following way:

- Thoroughbred Development Fund (0.75% of Thoroughbred races)
- Standardbred Development Fund (1.0% of Standardbred races)
- Equine Drug Testing Fund (0.1% of Thoroughbred races, capped at \$320,000)
- Equine Industry Fund (0.2% of Thoroughbred races, capped at \$650,000)
- Higher Education Equine Fund (0.1% of Thoroughbred races, capped at \$320,000)

In an effort to remain competitive within the industry and with out-of-state competitors, associations contribute 15% of net takeout to free plays on historical horse racing machines. The use of free plays encourages players to utilize historical horse racing facilities within Kentucky. Free plays are utilized by all of Kentucky's out of state competitors.

After taxes and free plays are taken out, horse racing associations are also required by 810 KAR 6:010 Section 6(2) and the federal 1978 Interstate Horse Racing Act to enter into agreements with a horsemen's organization to establish the allocation of the takeout on all exotic wagers on historical horse races offered by the association. These moneys are used by the horsemen's organization for purse money. In Kentucky, 15% of the total takeout from horse racing associations is provided to Kentucky horsemen by way of contractual purses.

At the third meeting of the task force on September 13th, 2021 representatives from the Kentucky Center for Economic Policy and Churchill Downs discussed the effective tax rate of historical horse racing with members of the task force. When subtracting free plays and contractual purses from the takeout received by the track, the effective tax rate on net takeout is approximately 32.3%. When this rate is compared to other states with historical horse racing facilities or other forms of gaming, Kentucky ranks as the second highest effective tax rate.

Mid-Level Revenue Effective Tax Rate by State

Churchill Downs Incorporated presented information to compare Kentucky's tax rate to competing locations and other historical horse racing operators in the United States. Kentucky's current combined effective tax rate is higher than most neighboring states and other historical horse racing jurisdictions.

- Ohio Casinos – 33.0%
- **Kentucky HHR – 32.3%**
- New Hampshire HHR – 29.4%
- Illinois Racino – 28.9%
- Indiana Racino – 27.0%
- Wyoming HHR – 25.8%
- Virginia HHR – 22.0%
- Illinois Casinos – 15.9%
- Indiana Casinos – 15.6%
- Arkansas Racino – 13.0%

Track and horse racing associations also pay substantial amounts of other taxes, including occupational, payroll, and property taxes. Wagering on historical horse racing has spurred the overall horse racing industry within Kentucky. The pari-mutuel tax and contractual obligations to purse money for horsemen are attributed to the substantial growth of one of the signature industries within Kentucky, whereas many other states have seen a decline in the horse racing industry.

Elasticity of the Pari-Mutuel Tax

The degree to which an increase in the tax rate causes a change to the amount of tax revenue received is called the elasticity of taxes. Dr. Tom Lambert from the University of Louisville Equine Industry Program provided insight on the elasticity of the pari-mutuel tax to the members of the task force at their fourth meeting on October 4, 2021.

If the demand for a product or activity is inelastic, a higher tax on that product or activity will cause only a small fall in demand, and tax revenues will increase accordingly. If demand is elastic, then an increase in tax, will lead to a larger percentage fall in demand, which is effective in reducing demand but less effective in raising revenue.

Elasticity varies among different industries as tax increases potentially decrease consumer demand within that industry. This is often due to substitution effects which result in consumers finding alternatives to the taxed item being purchased.

There have been no recent tax increases in Kentucky, so there is no substantial data on the elasticity of the pari-mutuel tax. However, there is data related to comparable gaming industries. Overall, tax increases on the gaming industry in general are highly elastic. This is mostly due to gaming providers returning less money to the public as taxes are increased on that industry. The

amount returned to the public from a specific form of gaming is observed and highly scrutinized from frequent gamblers and they will often find alternative methods for gaming if payouts decrease.

Kentucky also has a high number of competitors along its border with appealing large-scale gaming facilities because of legalized casino gambling and sports wagering in our border states. The high level of strong competition increases the potential for high elasticity of the pari-mutuel tax in Kentucky. Gaming ultimately occurs in the location of the highest payout.

Potential tax increases to the pari-mutuel tax and net revenues would likely have a much higher effective tax rate due to the establishment paying out approximately 90 to 95 percent of gross revenue to patrons. In order to have historical horse racing in Kentucky, a facility must operate a race track. That type of facility generates substantial fixed overhead costs. These fixed costs are often supplemented with revenue generated from historical horse racing.

One of the most effective ways in which the industry can increase its contributions in state revenue is through activating and expanding more historical horse racing opportunities in Kentucky. Recent reports suggest that there are multiple opportunities for race tracks across the state to increase historical horse racing in the Commonwealth. Turfway Park and Derby City Gaming plan to add around 2,000 machines over the next few years. With all statistical factors remaining constant, along with gaming competitors maintaining current practices, an increase in state tax revenue of approximately \$51 million per year may be generated.

Chapter 4

Equine Education Programs

At the fourth meeting of the task force, members focused on the educational institutions in Kentucky which specialize in the equine industry and equine studies. Representatives from the University of Kentucky, Bluegrass Community and Technical College, and the University of Louisville attended and presented information on their programs to members of the task force.

University of Kentucky

The University of Kentucky's Agriculture Equine Program has a mission which revolves around three core ideas. These are producing workforce-ready graduates, conducting world-renowned research, and providing service to the horse industry and the state. University of Kentucky Equine has been able to address many major issues within the industry. These include the production of the 2022 Kentucky Equine Survey, medical research and response to the Novel Rotavirus, as well as track surface research and testing. The University of Kentucky also works to empower horse owners throughout the state by maintaining the busiest diagnostic laboratory in North America for horses and engaging with horse owners in over 100 counties through the cooperative extension program.

Graduates of the University of Kentucky Equine Program pursue a variety of diverse academic programs including veterinary school, business and management programs, and other professional programs. Over 500 alumni currently work in various equine-affiliated fields, with 88 percent of all former graduates of the program still in the equine industry. The UK Equine Program brings in many out-of-state students, with that population consisting of 69.7 percent of all students in the program and 56.8 percent of total graduates stay in Kentucky.

The program's operational budget is currently approximately \$500,000 and is being sustained on internal re-allocated college funding. The UK Equine Program also receives support from the Higher Education Equine Fund, which is funded by the pari-mutuel tax and allocated by the Council on Postsecondary Education. Five state universities are currently utilizing these funds, which are restricted for use only for teaching infrastructure and large equipment. The University of Kentucky hopes to be able to invest in numerous advancements in their program, including graduate programs, expansion of youth education programs, and infrastructure. They also hope to be able to provide more stability for their operational budget in the future.

Bluegrass Community and Technical College

The Bluegrass Community and Technical College (BCTC) Equine Program provides a unique community-college based program with a goal of helping to solve workforce needs of the equine industry. They offer a two year associate degree in applied science in equine studies, along with certificates in equine industry workforce, equine veterinary assistance, and exercise riding. The college also works with high schools, offering dual credit opportunities for students wishing to advance into the equine industry.

The BCTC Equine Program hopes to be able to invest in their program in order to be able to care for their 12 horses, recruit minority and international students by working to develop its student exchange program, and increase course offerings and credentials. BCTC Equine has significant costs related to the operations of their program, with one of the most substantial costs being the operation of their barn. Annual barn expenses are approximately \$130,000 a year. This level of fixed expense is difficult for the program to maintain considering that they charge low tuition rates, approximately \$7,500 a year for an out-of-state student and \$2,100 a year for an in-state student. Ultimately, BCTC Equine shares many of the same costs as the equine programs at the University of Kentucky and the University of Louisville, while their tuition costs are substantially lower.

University of Louisville

The Equine Industry Program at the University of Louisville was created by the Kentucky Legislature in 1986 and is the only statutory equine program in the state as well as the only equine business program which is accredited by the Association to Advance Collegiate Schools of Business. The Equine Industry Program offers a bachelor of science degree in business administration with a concentration in equine administration. The University of Louisville also offers an undergraduate certificate in equine business and a graduate certificate in horse racing industry business.

The Equine Industry Program at the University of Louisville has made many substantial contributions to the horse industry in Kentucky. Approximately half of all students in the program come from out-of-state, and 57 percent of graduates of the program remain in Kentucky after graduation. University of Louisville professors have also made substantial research contributions focusing on the equine industry in Kentucky. The Equine Industry Program has also created a pilot program for high school students which highlight recruitment, student success, and student support. The University of Louisville also maintains the Racing Officials Accreditation Program which elevates and educates stewards, judges, and other racing officials.

The Equine Industry Program is the only program which receives moneys from the Equine Industry Fund, which is funded by the pari-mutuel tax. A portion of the revenues generated from the pari-mutuel tax on live, simulcast, and historical horse racing are deposited into the Equine Industry Fund. The fund has seen a decrease in funding every year since fiscal year 2017, with decreases of 16.46 percent in fiscal year 2020, and 15.25 percent in fiscal year 2021. These decreases are due to less revenue generated by live racing during that time period. In fiscal year 2017, the University of Louisville received \$939,212 from the Equine Industry Fund, while in fiscal year 2021 the fund's contributions have dropped to \$775,781. Historical horse racing contributions make up 83.79 percent of the Equine Industry Fund, which has increased 71 percent from fiscal year 2018-2019. This increase is attributed in large part to the substantial growth of historical horse racing in Kentucky. Because the distribution to the Equine Industry Fund from wagers on historical horse racing is capped at \$650,000 annually, the growth in historical horse racing has not translated into an overall growth in total moneys in the fund. The university's program is also eligible to receive funds from the Higher Education Equine Fund, which supports other equine programs throughout Kentucky, but the University of Louisville has recently not accepted any money from this funding.

Chapter 5

Recommendations

- Determine whether the imposition of the admission tax should continue since some tracks are not charging an admission;
- Evaluate whether a technical change to the statute should be made to remove the higher pari-mutuel tax rate since no race track has qualified for the higher rate during the past twelve years; and consider whether the tax rate on advance deposit account wagering remains appropriate since the industry has had sufficient time to establish a market.
- Review the cap on allocations to the University of Louisville equine education program; and evaluate the potential for the University of Kentucky and Bluegrass Community and Technical College to receive state funds.
- Evaluate the potential of legalized sports wagering in order to compete with out-of-state competitors