

PARI-MUTUEL WAGERING TAXATION TASK FORCE

Minutes of the 3rd Meeting of the 2021 Interim

September 13, 2021

Call to Order and Roll Call

The 3rd meeting of the Pari-Mutuel Wagering Taxation Task Force was held on Monday, September 13, 2021, at 3:00 PM, in Room 169 of the Capitol Annex. Representative Adam Koenig, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Damon Thayer, Co-Chair; Representative Adam Koenig, Co-Chair; Senators Julie Raque Adams, Denise Harper Angel, Christian McDaniel, and Stephen West; Representatives Al Gentry, Matthew Koch, and Jason Petrie.

Guests: Jason Bailey, Executive Director, Kentucky Center for Economic Policy; Mike Anderson, President, Churchill Downs Racetrack; and Vince Gabbert, Vice President, Strategic Initiatives & Legislative Affairs, Keeneland Association Incorporated.

LRC Staff: Tom Hewlett, Jennifer Hays, Grant Minix, and Chase O'Dell.

Approval of Minutes

A motion was made by Representative Koch, seconded by Senator McDaniel, to adopt the minutes of the August 9, 2021, meeting. The motion carried by voice vote.

Effective Tax Rate for Historical Horse Racing

Jason Bailey, Executive Director, Kentucky Center for Economic Policy; and Mike Anderson, President, Churchill Downs Racetrack, discussed the effective tax rate for historical horse racing.

Jason Bailey testified that Kentucky has a tax on historical horse racing (HHR) of 1.5 percent of the handle. In the most recent year, 91 percent of total handles returned to the public. Net commission of handles totaled 7.2 percent in the same year. A majority of HHR tax revenues go to industry funds. The remainder of tax revenues go to the general fund.

Handles on HHR have grown dramatically, from \$373 million in fiscal year 2015 to \$4.6 billion in fiscal year 2021. There were an average of 3,824 HHR terminals running

in fiscal year 2021, which grew up to 5,000 as of July, 2021. The payout percentage with HHR machines is very similar to slot machines in other states.

It is more typical to tax on net wagering rather than on handles. In nearby states where there is a tax on net wagering, rates are much higher. In Kentucky, revenues from the handle tax totaled 17.3 percent of gross commissions that operators earned in fiscal year 2021, making the effective tax rate on HHR 17.3 percent of gross commissions. Of that 17.3 percent, more than half goes to the various industry funds, with less than half going to the general fund. When considering only revenues that go to the general fund, the effective tax rate on HHR as a share of gross commission is 7.7 percent.

In response to a question from Representative Koenig, Mr. Bailey stated that the conversation concerning an appropriate HHR tax rate should start with the four bills or amendments which were introduced in the 2021 regular session.

In response to a question from Senator McDaniel, Mr. Bailey testified that the effective tax rate he presented represents the bottom line of what is reported to the Horse Racing Commission. He continued to say that the Kentucky Thoroughbred and Kentucky Standardbred development funds include purse supplements. Mr. Bailey continued to state that it is difficult to call the regulation requiring a contract between tracks and the horsemen's associations a tax, because there is no minimum contribution or duration required by the regulation. Essentially, 92 percent of the income on commission goes back to the industry in various forms, while eight percent goes to the general fund.

Senator Thayer stated that the model of requiring tracks to contract with horsemen's associations is the model used nationwide, and is governed by federal law. In response to questions from Senator Thayer, Mr. Bailey stated that he has a master's degree in public finance and has been looking at economic issues in Kentucky for over 20 years. He continued to say that he operates a non-profit organization that has a payroll with 10 employees. Mr. Bailey said that he has never worked at a racetrack. Senator Thayer stated that the effective tax rate on horse racing is much higher than the 1.5 percent rate established by the General Assembly. He continued to say that HHR is taxed in Kentucky similarly to other states. HHR is also taxed similar to how other states tax casino and slot operations. In response to another question from Senator Thayer, Mr. Bailey testified that he has never run a for-profit business.

In response to a question from Representative Koenig, Mr. Bailey testified that several of the industry funds are capped, and would have received higher revenues if not for the cap. In response to another question, Mr. Bailey said that he used fiscal year 2021 data because it was the most recent year, as well as because there was growth in volume in that year.

Mike Anderson testified that a statutory excise tax of 1.5 percent of handle exists on all money wagered on historical horse races. Revenues from this excise tax are

distributed between numerous research programs, funds, and the general fund. The breed development funds are essential to the growth Kentucky's horse industry.

Kentucky administrative regulation requires each racetrack association to enter into an agreement with the respective breed horsemen's associations to establish the allocation of a portion of the take-out to purse money. These regulatory obligated contracts with horsemen are required in order to operate HHR machines, as well as live racing and simulcast racing.

Purse money is statutorily established in some of the states Kentucky competes against. In Kentucky, all contracts with racetrack associations are tied to 15 percent of net revenue. Net revenue is calculated as takeout, minus free play and excise taxes. Contracts typically run for 10 years. The excise tax combined with the purse money obligated under the regulatory requirements form the effective tax rate.

If \$100 is wagered on a HHR in Kentucky, with an average takeout rate of 8.66 percent, \$8.66 is returned to the track, while \$91.34 is returned to the public via allocated wagering pools and is paid out to the winners. In order to incentivize customers to wager on HHR, tracks will issue free play, which averages approximately 15 percent of takeout or one percent of handle. Free play is a marketing tool used to drive traffic into the facility and is common practice for the gaming industry as a whole.

The Kentucky excise tax is applied on the total handle. After payout, free play, and the excise tax are applied, tracks are left with an average of \$5.86 of the initial \$100 wager. When factoring these, the effective excise tax rate on cash takeout becomes 20.4 percent. The contractual purse obligation for tracks in Kentucky is equivalent to an 11.9 effective tax rate of takeout after free play. When factoring the excise tax and contractual purse obligation, the combined effective tax rate becomes 32.3 percent of revenue for the racetrack.

Kentucky's borders are surrounded by direct casino or video lottery competition. These states hold competitive gaming advantages over Kentucky due to their slot machines, card and table games, and sports wagering.

Kentucky's effective tax rate is already on the high-end of rates compared to border states.

In response to a question from Senator McDaniel, Mr. Anderson testified that the federal regulation requires that a contract be enacted between horsemen associations in each respective state and the track associations in order to conduct simulcasting across state borders. In response to another question, Mr. Anderson stated that racetracks must contract with local and state horsemen's associations in accordance with regulatory guidelines. The rate established by these purse contracts varies between states and rarely fluctuates. In

response to a final question from Senator McDaniel, Mr. Anderson said that to remain competitive Kentucky should continue what it has been doing. The passage of Senate Bill 120 has allowed racetracks to continue to invest in their businesses, which will continue to increase the total handle of HHR.

In response to a question from Representative Gentry, Mr. Anderson stated that it is necessary to consider the mandatory contractual purse agreements with horsemen's associations to compare the competition between Kentucky and other states, some of which have statutory purse components. Representative Gentry stated that HHR has saved the horse racing industry in Kentucky. In response to another question, Mr. Anderson stated that he was unsure whether there were licensing fees for HHR machines.

Representative Koch stated that horsemen like HHR because it has allowed the business to grow. He continued to say that the industry is taxed heavily.

In response to a question from Representative Koenig, Mr. Anderson stated that most other states that Kentucky is competing against do not tax free play as Kentucky does.

Senator Thayer discussed the benefit of how prize purse winnings trickle throughout Kentucky's economy. Senator Thayer stated that Kentucky is taxing HHR at a rate similar to, or higher than, surrounding states. He continued to question why Kentucky would want to increase taxes on a signature industry such as horseracing. In response to a question from Senator Thayer, Mr. Anderson testified that Churchill Downs pays payroll taxes, occupational taxes, property taxes, and more, which amount to a significant amount of tax dollars to the commonwealth.

Current and Future Capital Investments at Kentucky's Tracks

Vince Gabbert, Vice President, Strategic Initiatives & Legislative Affairs, Keeneland Association Inc., discussed current and future capital investments at Kentucky's tracks.

Vince Gabbert testified that in the last three years, there has been significant investment at Kentucky Downs. Every market and facility is experiencing growth. Significant investment has translated to permanent jobs as well as construction jobs and occupational and local taxes. The amount of demand in Kentucky for stalls is at an all-time high. The actions of the General Assembly have helped drive this demand.

The purse structure in Kentucky is unique because tracks fund the bulk of it. Purses since 2018 have grown significantly, especially for those who are breeding and racing horses in the commonwealth.

In response to a question from Senator Thayer, Mr. Gabbert stated that each racetrack association goes through a licensing process with the Horse Racing Commission,

which is funded by the racetracks through unclaimed pari-mutuel tickets and assessments. On average, each HHR facility has 220 to 280 full-time employees. The cost to own and operate an HHR machine could range from \$11,000 to \$17,000 per machine. Senator Thayer spoke to the economic impact of the industry's \$1.5 billion of investments.

With no further business before the committee, the meeting was adjourned.