



Report Of The Pari-Mutuel Wagering Taxation Task Force

Research Memorandum No. 530

Kentucky Legislative Research Commission

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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 historical horse racing tax receipts are allocated, and
- determine whether any changes should be made to the current system.

The task force received testimony from various individuals and associations affiliated with the horse industry. 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 this topic and informing the task force members.

Jay D. Hartz
Director

Legislative Research Commission
Frankfort, Kentucky
November 2021

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Summary

The Legislative Research Commission developed the Pari-Mutuel Wagering Taxation Task Force to study

- taxes and rates related to the horse racing industry,
- the effect that changing rates would have on that industry, and
- distributions of the pari-mutuel tax receipts to funds relating to the horse industry, and to recommend any necessary changes to the current structure.

The 10-member task force held five public meetings beginning on July 16, 2021. Officials and entities in the horse industry provided testimony and information to assist task force members in answering questions about relevant issues.

At its meeting on November 19, 2021, the task force adopted this report detailing the findings that 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,
- equine education programs at Kentucky universities, and
- potential measures to assist patrons.

Chapter 1

Overview Of Taxes Paid By The Horse Racing Industry

Along with paying the same taxes as any other business 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—racetracks that conduct licensed horse racing must pay three additional fees or taxes: a license fee, the racetrack admission tax, and the pari-mutuel tax. The Legislative Research Commission, through 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 Pari-Mutuel Wagering Taxation Task Force at its first meeting.

As a licensed industry in Kentucky, a racetrack must pay a license fee. The license fee charged to Kentucky racetracks 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 racetrack'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 FY 2017, the annual receipts from the license fee on Kentucky racetracks have averaged approximately \$260,000. These receipts are deposited into Kentucky's general fund.

Licensed Kentucky racetracks must also collect and pay an admission tax of 15 cents for each person who enters the grounds or enclosure of any racetrack at which a live race meeting is being conducted. Racetracks that charge admission are able to pass this tax on to their patrons, but some racetracks do not charge an admission fee. KRS 138.480 requires racetracks to pay the admission tax on both paid and free admissions. A track not charging an admission fee typically estimates the number of patrons at the facility during a given race meeting and pays the admission tax based on that estimate. The admission tax is to be paid by each racetrack within 30 days after each race meeting. Prior to fiscal years 2020 and 2021, which were affected 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 racetracks is the pari-mutuel tax. It is collected based on various percentages applied to the taxable base of all money wagered on live racing, historical horse racing, and intertrack and simulcast racing. Racetracks must 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 must also be reported and paid by companies that provide advance deposit account wagering via electronic accounts through which Kentucky residents make wagers. Such companies are not racetracks but may be affiliated with a racetrack in Kentucky.

The amount of revenue collected from the pari-mutuel tax has grown substantially, rising from \$6.8 million in FY 2017 to \$31.2 million in FY 2021, an increase of approximately 360 percent. Receipts generated by the 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 fee and taxes paid by these licensed taxpayers.

Table 1.1
Additional Fee And Taxes Paid By Racetracks

	License Fee	Admission Tax	Pari-Mutuel Tax
Statute	KRS 137.170	KRS 138.480	KRS 138.510 et seq.
Who pays	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	Each person entering the grounds of any racetrack at which a live race meeting is being conducted under the jurisdiction of the Kentucky Horse Racing Commission	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
Description and rate	A license fee based on average daily mutuel handle for each day of racing: <ul style="list-style-type: none"> \$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+.....\$2,500 	A tax of 15 cents for each day	An excise tax with various 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%
Payment date	Tentative report and payment filed 30 days following the close of each duly licensed race meeting; final report due on or before December 31	Collected by the racetrack from each person and paid to the state within 30 days after the end of each race meeting	Weekly report and payment of tax, no later than the fifth business day following the close of each week of racing during the race meeting

Source: Kentucky Revised Statutes.

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 as follows, varying by type of wager:

- Live racing:
 - 1.5 percent for each track with a daily average live handle of less than \$1.2 million
 - 3.5 percent for each track with a daily average live handle of \$1.2 million or more
- Historical horse racing: 1.5 percent
- Intertrack and simulcast racing: 3 percent
- Advance deposit wagering: 0.5 percent

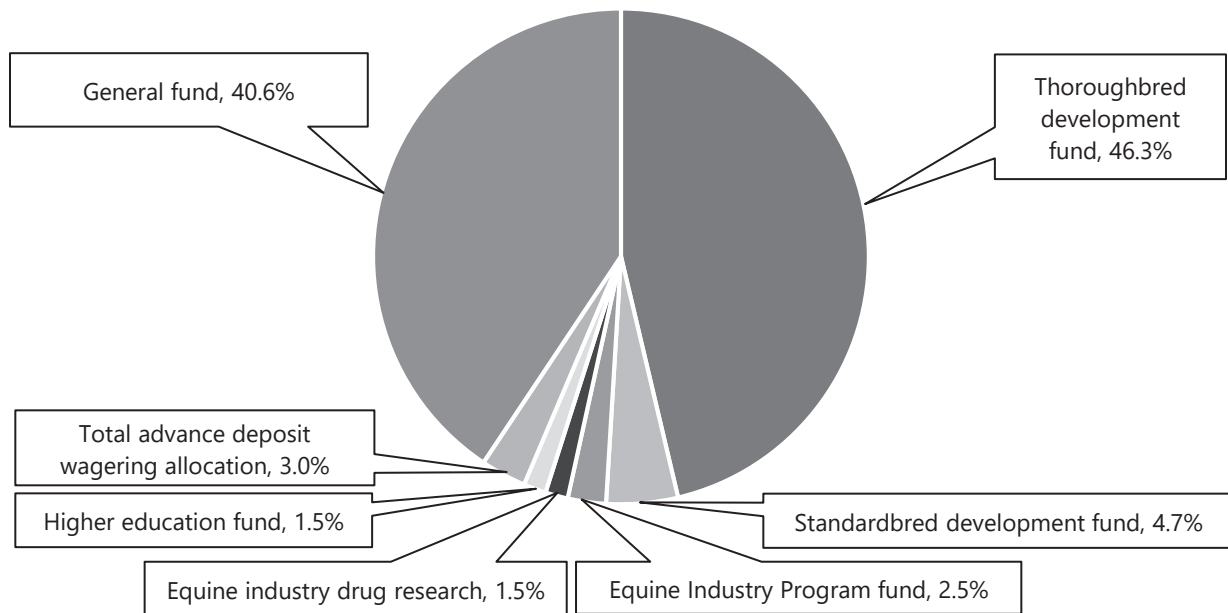
The revenue collected from the pari-mutuel tax is distributed to various funds. Three of them provide money to benefit the horse industry in Kentucky: the Kentucky Thoroughbred development fund; the Kentucky Standardbred development fund; and the Kentucky quarter horse, paint horse, Appaloosa, and Arabian 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 the corresponding breed of horse. This money may be used for various purposes, including the promotion, enhancement, improvement, and encouragement of breed development; purse supplements; and improvement of the overall quality of racing.

In addition to the three development funds, distributions are also made to postsecondary educational programs that focus on the equine industry. The Equine Industry Program fund is established for use by the Equine Industry Program of the University of Louisville (UofL), 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 Kentucky universities and is restricted to capital purchases and teaching infrastructure.

Revenue from the pari-mutuel tax is 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 such revenue—46.3 percent—was deposited into the Kentucky Thoroughbred development fund. 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 of the total revenue generated in 2019. Figure 1.1 shows the FY 2019 distributions.

Figure 1.1
FY 2019 Pari-Mutuel Tax Revenue Allocations



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

Pari-Mutuel Tax Distribution

Live Race Wagering

According to KRS 138.510, live racing wagers are taxed at either 1.5 percent or 3.5 percent of all money wagered. Racetracks with a daily average handle under \$1.2 million are taxed at the 1.5 percent rate. Those with a daily average live handle of \$1.2 million or more are taxed at the 3.5 percent rate, but no racetrack in Kentucky has met that criterion since FY 2008.

For receipts from Thoroughbred racetracks, 0.75 percent of all money wagered is deposited into the Thoroughbred development fund, 0.20 percent is deposited into the Equine Industry Program 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 racetracks, 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 1.2 outlines these percentages by type of fund.

Table 1.2
Percentage Distributions From Live Wagers

	% Of Live Wagers Distributed	
	Thoroughbred Racetrack	Standardbred Racetrack
Pari-mutuel tax (percent of handle)	1.5%	1.5%
Designated distributions		
Development funds	0.75%	1.00%
Equine Industry Program fund	0.20	0.20
Higher education equine fund	0.10	0.10
Equine drug testing fund	+ 0.10	+ 0.10
Subtotal	1.15	1.40
Designated distributions subtotal	-1.15	- 1.40
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 is distributed to postsecondary equine education programs: 0.2 percent to the Equine Industry Program fund and 0.1 percent to the higher education equine fund. After an additional 0.1 percent of revenue is distributed to the equine drug testing fund, the remaining revenue (0.35 percent of total handle from wagers at a Thoroughbred racetrack and 0.1 percent from wagers at a Standardbred racetrack) 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 FY 2019. On average, a typical \$2 wager placed on a live race returns \$1.61 to the public in winnings, with \$0.34 going back to the host racetrack in net commission, \$0.03 going to the pari-mutuel tax, \$0.01 going to the Backside Improvement Fund, and \$0.01 going to breakage.

Historical Horse Racing

Historical horse racing is the largest generator of revenue from the various pari-mutuel taxes. The tax rate on historical horse racing wagers is 1.5 percent of all money wagered. The various funds that receive distributions from live racing also receive funds generated from historical

horse racing at the same percentages. However, the Equine Industry Program 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 each year. Table 1.3 shows the percentages at which distributions are made from historical horse race wagers.

Table 1.3
Percentage Distributions From Historical Horse Race Wagers

	Type Of Racetrack	
	Thoroughbred	Standardbred
Pari-mutuel tax (percent of handle)	1.5%	1.5%
Development funds	0.75	1.00
Equine Industry Program 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 FY 2019, historical horse racing generated 81.6 percent of the total revenue generated by the pari-mutuel taxes. On average, a typical \$2 wager on a historical horse race returns \$1.83 to the public, which leaves \$0.14 to be collected by the host track in net commission, and \$0.03 allocated to the pari-mutuel tax.

Intertrack And Simulcast Wagers

Intertrack and simulcast wagers are taxed at a rate of 3 percent of all money wagered. The Thoroughbred development fund and Standardbred development fund each receive 2 percent of the total handle from intertrack and simulcast wagers based on the breed on which wagers are made. The postsecondary equine education programs receive 0.15 percent of the total handle, with the Equine Industry Program fund receiving 0.05 percent 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 1.4 outlines these distributions.

Table 1.4
Percentage Distributions From Intertrack And Simulcast Wagers

	Thoroughbred Racetracks
Pari-mutuel tax rate (percent of handle)	3.00%
Designated distributions	
Development fund	2.00%
Equine Industry Program fund	0.05
Higher education equine fund	0.10
Equine drug testing fund	0.10
Subtotal	2.25
Designated distributions subtotal	- 2.25
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 FY 2019. On average, a typical \$2 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, \$0.06 allocated to the pari-mutuel tax, and \$0.01 going to breakage.

Advance Deposit Account Wagering

Advance deposit account wagers are taxed at 0.5 percent of 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 that 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 1.5 describes this distribution.

Table 1.5
Percentage Distributions From Advance Deposit Account Wagering

Source	Percentage Distributed
Pari-mutuel tax (percent of handle) (KRS 138.513)	0.50%
Wager on a Kentucky race (distributed to association conducting race)	85% (0.425% of handle)
Wager on non-Kentucky 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 \$2 wager on an advance deposit account returns \$1.56 to the public, with \$0.39 being collected in net commission, \$0.03 going to breakage, and \$0.01 going to the pari-mutuel tax.

Chapter 2

State Of The Horse Industry In Kentucky

On August 9, 2021, at the second meeting of the task force, the Kentucky Equine Education Project presented information related to the strengthening of the horse industry, and how it could 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 in the state. Much of the industry's recent success can be attributed to the passage of 2021 Senate Bill 120, which protected historical horse racing and paved the way for significant investment in the horse industry.

With a total economic impact of \$6.5 billion, the horse industry has given Kentucky a substantial economic boost. Within the commonwealth, the equine industry provides nearly 80,000 jobs in many job sectors, contributing to various Kentucky communities—not just those with horse racing facilities or horse farms. One horse contributes to a variety of 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 that 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 results in \$209 million in direct value to Kentucky's economy, as well as almost 6,000 jobs. One such form of recreation is trail riding; nearly half of all trail riders in Kentucky have come from out of state.

A bright future is anticipated for the state's horse industry. In Kentucky, 30.5 percent of households have a horse enthusiast in the family. Minors make up 38 percent of horse enthusiasts within Kentucky—a much higher rate than the national average of 23 percent. Another bright spot that factors into Kentucky's future is the 10 postsecondary institutions and technical training programs that offer equine education: Asbury University, Bluegrass Community and Technical College (BCTC), Georgetown College, Kentucky Horseshoeing School, Midway University, Morehead State University, Murray State University, University of Kentucky (UK), University of Louisville, and Western Kentucky University. Nearly 80 percent of graduates of these institutions and programs stay in Kentucky, even though these students come from all over the world.

State Of The Standardbred Industry In Kentucky

In addition to its report on the state of the horse industry as a whole, the Kentucky Equine Education Program provided insight into the 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 through pari-mutuel taxes on moneys wagered at Standardbred races, including historical horse racing.

Before the advent of historical horse racing, the Kentucky Standardbred development fund paid out less than \$100,000 in annual purse supplements, but in 2019, it paid out \$1,716,556.

Prior to the growth of historical horse racing, two Standardbred tracks closed: Thunder Ridge Raceway and Players Bluegrass Downs. The growth of historical horse racing has provided larger purses for Standardbred racing, and two new Standardbred tracks are to open soon in Corbin and Oak Grove. The track in Corbin is to 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 is to add approximately 350 jobs, mostly full-time positions.

Thanks to this growth, Standardbred purses have nearly tripled, allowing for the success of Standardbred programs such as the Kentucky Sire Stakes, whose participation is five times as high as in 2014. The Kentucky Proud Series Fair Program had been on the verge of failure prior to historical horse racing, but it paid out over \$540,000 in purses in 2020 and over \$780,000 in 2021. Kentucky is poised to soon become a national leader in the Standardbred industry, and historical horse racing will be 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 for nearly two decades, even though there has been a substantial decline in most major horse-producing states and throughout the United 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 the industry's success in the commonwealth is 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, leading in turn to more money being wagered and larger revenues for the general fund and the various development funds by way of the pari-mutuel tax.

Similarly to what has happened in the Standardbred industry, increases in wagering on historical horse racing have 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 in Kentucky since 2003. Kentucky has the highest average field size in the nation, and is one of only three major horse racing states that have increased or maintained the average field size since 2012, as detailed in Table 2.1.

Table 2.1
Comparison Of Average Field
2012, 2019, And 2020

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

Source: Kentucky Thoroughbred Association.

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

Kentucky’s strong Thoroughbred industry helps attract and maintain a variety of high-paying jobs, such as veterinarians, operations managers, agricultural managers and workers, and animal scientists and breeders. Many major owners and trainers throughout the world benefit Kentucky by operating satellite facilities, buying homes and farms, and establishing principal places of operations and training centers here. High-wage workers from horse racing, along with large-scale horse racing entities that have come to Kentucky, make significant contributions to the state’s economy and the general fund through a combination of the sales, income, and property taxes.

Many factors influence Kentucky’s ability to maintain its position among the top states for Thoroughbred production and Thoroughbred racing. Most important is the business environment that has been created through public policy achievements and a favorable tax structure. At one time, Kentucky was at a competitive disadvantage throughout the nation, but thanks to advancements in historical horse racing and the success of the Kentucky Thoroughbred development fund, Kentucky is poised to maintain its rich history of Thoroughbred breeding and racing and to remain as one of the horse industry’s global leaders.

Future Capital Investments At Kentucky’s Tracks

Over the last 5 years, approximately \$1.5 billion has been invested at Kentucky horse tracks and facilities, as shown in Table 2.2, and every market and facility has experienced growth. These investments contributed to statewide growth in jobs and tax-related revenues.

Table 2.2
Investments In Kentucky Racetracks
2016 To 2021

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

Source: Keeneland Association.

The all-time high demand for stalls in Kentucky is related to the substantial increase since 2018 in the purse amounts, which attracts horse racers to Kentucky.

As historical horse racing facilities continue to grow, they will have substantial impacts on Kentucky's job growth and economy. Each historical horse racing facility in Kentucky employs an average of 220 to 280 full-time employees. At the third meeting of the task force, leaders from two of Kentucky's biggest racetracks, Churchill Downs and Keeneland, presented information on current and future investments at Kentucky tracks. They suggested that if they are allowed to keep the current structures of taxation and regulation, the industry will continue to grow, leading to further demand within the industry and more economic benefit to Kentucky.

Claiming Races In Kentucky

At the fifth meeting of the task force, officials from the Kentucky Horsemen's Benevolent and Protective Association discussed how claiming races benefit the horse industry in Kentucky and the potential added benefits of allowing the Kentucky Thoroughbred development fund to contribute to claiming race purses. Today, the fund does not support purses in claiming races.

Claiming races are an essential aspect of American horse racing and an important way for the industry to grow in Kentucky. These races ensure a quality classification and ensure that racing outcomes are less predictable. When the outcome is less predictable, pari-mutuel wagers increase.

An owner can submit a horse to take part in a claiming race, in which comparable horses compete against one another. However, the horses that run in a claiming race are subject to being claimed by prospective licensed owners who submit the claiming price for the horses in a particular race. In this situation, the individual submitting the claim becomes the new owner of the claimed horse.

Claiming prices in Kentucky range from \$5,000 to \$150,000. The price is collected by the original owner of the horse who submits the horse in the claiming race, but only if the horse is claimed by another prospective licensed owner. Along with the claiming price, the original owner also collects any purse money the horse wins in the race. The potential for winning purse money is one of the main incentives for owners to submit a horse in a claiming race.

Claiming races make up roughly 50 percent of the races run in Kentucky, but only 17 percent of total purses are for claiming races. Since claiming races are often relied upon to fill programs, they are significant for events that have higher allowances, such as maiden and stakes races. Claiming races do not receive purse incentives from the Kentucky Thoroughbred development fund, so they have not enjoyed the same competitive advantage over other states that higher-stakes races in Kentucky are currently enjoying.

The absence of purse incentives has made it difficult for some tracks to fill slots for claiming races and fill their race programs throughout the year. Some owners are drawn to race their horses in other states that can maintain higher purses in claiming races, causing Kentucky to lose ground in terms of overall growth and revenue.

Chapter 3

Analysis Of Historical Horse Racing Taxes

Effective Tax Rates

According to the Kentucky Horse Racing Commission reports from FY 2021, money wagered on historical horse racing is 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 percent of total handle. The second largest amount is the net commission, which is retained by the owner of the facility where the wager is made, averaging 7.2 percent of total handle. Lastly, 1.5 percent of total handle is remitted as the pari-mutuel tax. The Kentucky Horse Racing Commission estimates that 0.2 percent of total handle makes up the amount lost in breakage and change in pools.

Of the 1.5 percent of the total handle representing the portion of the wager taxed, 0.67 percent is deposited into the general fund and the remaining 0.83 percent is distributed to horse racing industry funds:

- Thoroughbred development fund (0.75 percent of handle from Thoroughbred races)
- Standardbred development fund (1.0 percent of handle from Standardbred races)
- Equine drug testing fund (0.1 percent of handle from Thoroughbred races, capped at \$320,000)
- Equine Industry Program fund (0.2 percent of handle from Thoroughbred races, capped at \$650,000)
- Higher education equine fund (0.1 percent of handle from Thoroughbred races, capped at \$320,000)

In an effort to remain competitive within the industry and with out-of-state competitors, associations contribute 15 percent of net takeout to free plays on historical horse racing machines. The use of free plays encourages players to use historical horse racing facilities in Kentucky. All of Kentucky's out-of-state competitors offer free plays.

Under 810 KAR 6:010, sec. 6(2) and the federal Interstate Horse Racing Act of 1978, after taxes and free plays are taken out, horse racing associations must 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. This money is used by the horsemen's organization for purse money. In Kentucky, 15 percent of the total takeout from horse racing associations is provided to Kentucky horsemen by way of contractual purses.

On September 13, 2021, at the third meeting of the task force, representatives from the Kentucky Center for Economic Policy and from Churchill Downs discussed the effective tax rate of historical horse racing. After subtracting free plays and contractual purses from the takeout received by the track, the effective tax rate on net takeout is approximately 32.3 percent—the

second highest effective tax rate among states with historical horse racing facilities or other forms of gaming.

Representatives from Churchill Downs presented information, detailed in Table 3.1, showing that Kentucky's current combined effective tax rate is higher than that of competing locations and other historical horse racing operators in the United States.

Table 3.1
Midlevel Revenue Effective Tax Rate By State

Operator	Effective Tax Rate
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

Note: HHR = historical horse racing.

Source: Churchill Downs Inc.

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. 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, 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. Decreases are often due to substitution effects, in which consumers find alternatives to the taxed item.

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 are highly elastic, mostly because gaming providers return less money to the public as taxes on gaming are increased. Frequent gamblers monitor and scrutinize the amount that specific forms of gaming return to the public, and they will often find alternative methods for gaming if payouts decrease.

Because of legalized casino gambling and sports wagering in bordering states, Kentucky also has a high number of nearby competitors with appealing large-scale gaming facilities. 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 result in a much higher effective tax rate because an establishment pays out approximately 90 percent to 95 percent of gross revenue to patrons. In order to have historical horse racing in Kentucky, a facility must operate a racetrack, which generates substantial fixed overhead costs that are often supplemented with revenue derived from historical horse racing.

One of the most effective ways for the industry to increase its contributions to Kentucky's revenues is through activating and expanding more historical horse racing opportunities. Recent reports suggest that there are multiple opportunities for the state's racetracks to increase historical horse racing. Turfway Park and Derby City Gaming plan to add roughly 2,000 machines over the next few years. If all statistical factors remain constant and if gaming competitors maintain current practices, an annual increase of approximately \$51 million in state tax revenue may be generated.

Chapter 4

Equine Education Programs

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

University Of Kentucky

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

Graduates of the UK Equine Program pursue a variety of academic programs including veterinary school, business and management programs, and other professional programs. Over 500 alumni work in various equine-affiliated fields, and 88 percent of the program's graduates are still in the equine industry. The program brings in many out-of-state students, who make up 69.7 percent of all students in the program. Among all graduates of the program, 56.8 percent stay in Kentucky.

The program's operational budget of approximately \$500,000 is being sustained on internal reallocated 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 currently use these funds, which are restricted for teaching infrastructure and large equipment. UK hopes to invest in numerous equine-related advancements, including graduate programs, expansion of youth education programs, and infrastructure. The university also hopes to provide more stability for its operational budget.

Bluegrass Community And Technical College

The BCTC Equine Program provides a unique community-college based program with a goal of helping to solve workforce needs of the equine industry. It offers a 2-year associate's 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.

BCTC hopes to be able to invest in its equine program in order to be able to care for its 12 horses, recruit minority and international students by developing its student exchange program, and increase course offerings and credentials. Among BCTC Equine's significant program operation costs, one of the most substantial is operation of its barn. Annual barn expenses are approximately \$130,000. This level of fixed expense is difficult for the program to maintain, considering that its annual tuition rates are only approximately \$7,500 for an out-of-state student and \$2,100 for an in-state student. BCTC Equine's tuition rate are substantially lower than those of the equine programs at UK and UofL, yet it faces many of the same costs.

University Of Louisville

The General Assembly created the UofL Equine Industry Program in 1986. It is the only statutory equine program in the state, as well as the only equine business program 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. UofL also offers an undergraduate certificate in equine business and a graduate certificate in horse racing industry business.

The program has made many substantial contributions to Kentucky's horse industry. Approximately half of all students in the program come from out of state, and 57 percent of its graduates remain in Kentucky. UofL professors have made substantial research contributions focusing on Kentucky's equine industry. The program has also created a pilot program for high school students, highlighting recruitment, student success, and student support. UofL 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 to receive money 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 is deposited into the fund. The fund has seen a decrease in funding every year since FY 2017, including decreases of 16.46 percent in FY 2020 and 15.25 percent in FY 2021. These decreases are due to drops in revenue generated by live racing. UofL received \$939,212 from the equine industry fund in FY 2017 but only \$775,781 in FY 2021. Historical horse racing contributions make up 83.79 percent of the equine industry fund, which has increased 71 percent from FY 2019. This increase is attributed in large part to the substantial growth of historical horse racing. Because distributions to the fund from wagers on historical horse racing are capped at \$650,000 annually, the growth in historical horse racing has not translated into an overall growth in total money in the fund. UofL's program is also eligible to receive funds from the higher education equine fund, which supports other equine programs throughout Kentucky, but the university has recently not accepted any money from this funding.

Chapter 5

Potential Measures To Assist Patrons

Much has been done throughout Kentucky to assist the horse industry and ensure the success of one of the state's signature industries. At the fifth meeting of the task force, the Kentucky Council on Problem Gaming and the Thoroughbred Idea Foundation presented information on ways that the legislature could assist bettors, such as lowering the amount of breakage lost on winning bets, and using gambling-related tax revenues to fund a statewide program for problem gambling.

Breakage Reform

Breakage is the difference between what bettors should be paid for a winning bet and what they are actually paid. It began as a necessary practice for tracks to undertake in order to be more efficient in returning winnings to bettors, a process that for a long time was conducted exclusively via cash transactions. The tracks essentially rounded down the return from winnings in order to arrive at an amount that is more readily distributable in cash.

KRS 230.3615(1) and (2) outline that breakage must, at the very least, be calculated to the dime. For example, if a winning dividend on a pari-mutuel wager totaled \$9.7601, the payout would be \$9.70 if rounded down to the nearest dime, and the bet taker would retain \$0.0601 as breakage. If the same payout were rounded down to the nearest penny, the payout would be \$9.76, and the bet taker would retain \$0.001.

Even though breakage was originally designed to help racetracks, by increasing the efficiency of disbursing winnings, advances in off-track betting have created a situation where the majority of retained breakage is collected by off-track bet takers. In FY 2021, approximately 96.7 percent of breakage was held by bet takers that were not Kentucky racetracks. The estimated breakage retained by off-track bet takers totaled over \$9.3 million, compared with just over \$310,000 on-track.

As the competitiveness of the wagering industry throughout the country is rapidly expanding, experts in the horse industry are seeking ways to modernize pari-mutuel wagering and remain competitive with other forms of wagering. Gamers prefer wagers that have the highest opportunity for payout, so large breakages can hinder individuals from wagering on horse racing. Although pari-mutuel breakage is unavoidable due to the way winnings are calculated, the legislature can adjust the amount retained by the bet taker.

No other state's statutes require that breaks be rounded down to the nearest penny. If Kentucky became the first to make such a requirement, the state could benefit from an edge that favors the public and benefits the entire industry. This change would give customers more money to spend on subsequent wagers and would encourage them to do so with higher payouts.

Problem Gambling

In 2021, the National Council on Problem Gambling released a survey that concluded that 78 percent of adult Kentuckians had gambled within the past year, wagering approximately \$2 billion on legal gambling, from which the commonwealth received revenue of nearly \$300 million. As state legislatures throughout the country are legalizing various forms of gambling and working to develop the gambling industry overall, they are also allocating state funds to assist in programs for problem gambling. Even with the growth of the legal gambling industry in Kentucky, the state does not contribute state funds to such programs. Each racetrack in the state contributes to problem gambling programs, but services for problem gamblers, addicted gamblers, and their families are still scarce in Kentucky.

A gambling problem is indicated when a person continues to gamble despite continuously experiencing negative consequences. The survey conducted by the National Council on Problem Gambling estimated that Kentucky has nearly 9,000 addicted gamblers, 51,000 problem gamblers, and 190,000 people at risk of developing a gambling problem or addiction. Individuals with gambling problems often suffer from poor health and have increased chances of developing psychological disorders, particularly antisocial personality disorder. These factors contribute to increased domestic violence, and the suicide rate is higher for addicted gamblers than for any other victim of addictive disorder. There are also links between gambling problems and increased abuse of alcohol and substances. Each addicted gambler affects roughly 8 to 10 other individuals, and children of problem gamblers are 10 times more likely to develop a gambling problem themselves.

The Kentucky Council on Problem Gambling proposes that an investment in a statewide problem gambling program would help to negate the high costs that society pays in criminal justice and social services. These high costs are due to the significant impact of problem and addicted gamblers on state social costs, estimated at \$10 million to \$300 million per year. Each addicted gambler costs society \$1,200 to \$19,000 per year. Research indicates that for every \$1 invested in treatment of disordered gambling, there are savings of \$2 in social costs. Problem gambling and addicted gambling is a public health issue that can best be addressed through a state-operated program of evidence-based approaches to prevention, mitigation, and counseling.

Chapter 6

Recommendations

- Determine whether the imposition of the admission tax should continue, since some tracks are not charging an admission fee.
- Evaluate whether a technical change to statute should be made to remove the higher pari-mutuel tax rate, since no racetrack has qualified for the higher rate during the past 12 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 Industry 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.
- Allow the Kentucky Thoroughbred development fund to contribute funds to claiming race purses.
- Mandate that bet takers round down breakage to the nearest penny.
- Dedicate revenue from pari-mutuel wagering within Kentucky to a statewide problem gambling assistance program.

