

DATE: May 1, 2012
TO: Interested Parties
FROM: William E. Hamilton
RE: House Bill 5546 (H-1) Detailed Analysis

House Bill 5546 would amend 29 sections, and repeal two sections, of the Horse Racing Law of 1995, 1995 PA 279. The bill as introduced April 19, 2012 was identical to Senate Bill 1075, as introduced.

House Bill 5546 was amended in committee and an H-1 substitute reported April 25, 2012. The most significant difference between the bill as introduced and the H-1 substitute involves the tax on simulcast wagering. Those provisions are discussed in the *State Tax on Wagering/Fiscal Impact* section of this memo, below.

The House Fiscal Agency Legislative Analysis of the bill summarizes all of House Bill 5546's proposed amendments to the Horse Racing Act of 1995. This memo is intended to provide background information on the regulation of horse racing in Michigan and a more detailed analysis of some of the major provisions of House Bill 5546. This memo is not comprehensive and does not discuss all sections of the bill.

Office of Racing Commission: Transfer to the MGCB

Among other things, the Horse Racing Law of 1995 established, and prescribed the powers and duties of, the Office of Racing Commissioner. Under provisions of Section 3 of the Horse Racing Law of 1995 the Office of Racing Commissioner was created within the *Department of Agriculture*.

Executive Order 2009-45 abolished the Office of Racing Commissioner and position of Racing Commissioner, and transferred the functions and powers of the Office of Racing Commission from the Michigan Department of Agriculture to the Michigan Gaming Control Board (MGCB). The transfer is referenced as Executive Reorganization Order 2009-31 in Michigan Compiled Laws (MCL 324.99919). The effective date of the transfer was January 17, 2010. The Executive Order also directed that the Executive Director of the MGCB perform all the functions and exercise the powers of the Racing Commissioner.

House Bill 5546 would amend Sec. 2 of the Horse Racing Act of 1995 to define *Commissioner* or *Racing Commissioner* to mean the Executive Director of the MGCB, and to reference Executive Reorganization Order 2009-31. The bill would also define the *Office of Racing Commissioner* to mean the Horse Racing Section of the Horse Racing, Audit, and Gaming Technology Division of the MGCB under the direction of the Executive Director of the MGCB.

Office of Racing Commissioner/ Department of Agriculture and Rural Development

In addition to transferring the Office of Racing Commissioner to the MGCB, Executive Order 2009-45 transferred powers of the Commission of Agriculture to the Department of Agriculture. Executive

Order 2009-54 (Executive Reorganization Order 2009-38) subsequently transferred certain powers back to the Commission of Agriculture from the Department, including "*The authority, powers, duties, functions, responsibilities, and budgetary resources previously vested in the Commission of Agriculture under Section 20 of the Horse Racing Law of 1995, 1995 PA 279, MCL 431.320, and transferred to the Department of Agriculture under Executive Order 2009-45.*"

Section 20 of the Horse Racing Law of 1995 established the Agriculture Equine Industry Development Fund (AEIDF) and gave administrative responsibility for the AEIDF to the Director of the Department of Agriculture "*with the assistance and advice of the Racing Commissioner.*" However, the Commission on Agriculture had never had authority under Section 20 of the Horse Racing Law of 1995; there is no reference to the State Agriculture Commission anywhere in the Horse Racing Law of 1995. As a result, the language of Executive Order 2009-54 with regard to the Horse Racing Law of 1995 appears to be an anachronism.

Executive Order 2011-2 (Executive Reorganization Order 2011-2) changed the name of the Department of Agriculture to the *Department of Agriculture and Rural Development* (MDARD). House Bill 5546 would amend references to the department in Section 20 to reflect this name change. Under House Bill 5546, administrative responsibility for the AEIDF would remain with the MDARD Director "*with the assistance and advice of the Racing Commissioner.*"

House Bill 5546 would add a sentence to Section 20 to indicate that any money appropriated by the Legislature out of the AEIDF to the Racing Commissioner or Office of Racing Commissioner "*shall be administered only by the racing commissioner.*" Current year (FY 2011-12) AEIDF appropriations are as follows: \$2.3 million in the General Government budget for regulatory activities of the Racing Commission within the Michigan Gaming Control Board and related information technology costs; \$1.0 million in the Agriculture and Rural Development budget for laboratory, information technology, and administrative costs related to horse racing programs; \$2.8 million in the Agriculture and Rural Development budget for horse racing grants and purse supplements.

In effect, the bill maintains the current division of responsibilities between the Racing Commissioner within the MGCB and MDARD, with the Racing Commissioner having authority for licensing and regulatory functions under the act, and the MDARD administering the distribution of AEIDF grants and programs with the assistance and advice of the Racing Commissioner. It is our understanding that the Racing Commissioner assists the department in determining the distribution of owner and breeder awards.

Types of Wagering Currently Authorized

The Horse Racing Act of 1995 currently provides for two types of pari-mutuel horse racing in the state: *live horse racing*, and *simulcasting* of horse races. Live horse racing is self-explanatory; it involves wagering on the results of races run by live horses at the race track at which the wagers are placed. Simulcast racing involves wagering on horse races run at race tracks other than the track at which the wagers are placed. In simulcast racing the races and race results are broadcast in real time; i.e. *simultaneously*, from a remote race track, either in-state or outside-the-state, to the Michigan race track at which wagers are made.

The act does not currently define "pari-mutuel." As commonly understood, *pari-mutuel* refers to a system where persons wager against each other to win a common pool composed of those wagers, as opposed wagering games where persons compete against a "house" or game operator. Pari-mutuel wagering is the wagering system most commonly used in horse racing.

House Bill 5546 would amend Section 2 the act to define "pari-mutuel," "pari-mutuel gaming activities," and "pari-mutuel wagering" to mean *"the form or system of gambling on races, events, games, and activities in which the winner or winners divide the total amount of money bet, after deducting all commissions, fees, and taxes."* The bill would exclude from the definition *banked games* in which the race meeting licensee is a participant or holds a stake in the outcome of the game, or established a bank against which participants play. The bill would also exclude from the definition *"a video lottery that must be authorized under the McCauley-Traxler-Law-Bowman-McNeely Lottery Act..."*

House Bill 5546 would amend Section 7 regarding the powers and duties of the Racing Commissioner. Current law is permissive in allowing the Racing Commissioner to promulgate administrative rules ("The Racing Commissioner may...") for live horse racing and pari-mutuel wagering on the results of horse racing and simulcasting. House Bill 5546 would change "may" to "shall" and thus direct the Racing Commissioner to promulgate administrative rules – not only for live horse racing, and pari-mutuel wagering on *"live horse racing and simulcast racing and events,"* but also for *"pari-mutuel gaming activities."* House Bill 5546 would require that such administrative rules *"provide a process by which race meeting licensees may request and obtain approval from the racing commissioner to conduct and offer to the public all pari-mutuel wagering and pari-mutuel gaming activities consistent with this the act."*

House Bill 5546 would amend Section 8 to include "pari-mutuel gaming activities" under the licensed activities of occupational licensees and race meeting licensee. In addition, the bill would amend Section 14 to allow the Racing Commissioner, in granting a race meeting license, to also authorize the conduct of any other pari-mutuel wagering and pari-mutuel gaming activities *"including simulcasting and common, linked, or progressive pool wagering, as requested by the applicant..."*

House Bill 5546 would amend Section 17 to strike the specific and limiting reference to *"the results of horse racing"* under "pari-mutuel system of wagering" permitted under the act.

The bill would also strike language in Section 17 which currently permits wagering on live horse racing or simulcasting only within the enclosure of a licensed race meeting. The bill adds language to indicate that the act does not prohibit "account wagering" or "advanced deposit wagering." These terms are not defined in the bill. It is our understanding that "account wagering" and "advanced deposit wagering" refer to a system in which a person deposits money into a wagering account. The account is debited for wagers made in person, or remotely by telephone or other by internet. These systems allow persons to wager without being physically present at the race track.

House Bill 5546 would amend Section 27 to specifically authorize *"live horse racing, simulcast races and events, and gaming and activities with pari-mutuel wagering... to the extent that they are conducted in accordance with this act and not prohibited by federal law."*

House Bill 5546 places new definitions in Section 2, and the amendments to Sections 7, 8, 14, 17, and 27 would appear to allow the Racing Commissioner to authorize race meeting licensees to conduct other types of pari-mutuel wagering in addition to live horse racing and simulcast racing.

Types of Licenses Currently Authorized

Section 8 of the act currently provides for three types of licenses:

Occupational licenses are issued to persons involved in horse racing, pari-mutuel wagering, or simulcasting of horse races in the state. Occupational Licensing fees are established in Section 16

(9) at not less than \$10.00 nor more than \$100.00 as determined by the Racing Commissioner. This would not change under House Bill 5546.

Race meeting licenses permit a licensee to conduct live horse racing, simulcasting of horse races, and pari-mutuel wagering on the results of live and simulcast horse races. There is not a separate license fee associated with this license other than the 3.5% simulcast wagering tax imposed in Section 22. House Bill 5546 as introduced would have changed both the rate of taxation and tax base. The H-1 substitute as reported from committee retains the current basis of taxation.

Track licenses permit a licensee to operate a racetrack at which one or more race meeting licensee may conduct licensed race meetings. Section 22 of the act provides for an annual track licensing fee of \$1,000 for tracks located within a *city area* as defined in Section 2 of the act, and \$200 if located outside a city area. House Bill 5546 would make the fee \$1,000 per year for all applicants – House Bill 5546 would also strike the Section 2 definition of "city area."

Distribution of Money Wagered at Race Tracks

Sections 17, 18, and 19 of the Horse Racing Law of 1995 concern the distribution of money wagered on horse racing. The following description, and the table at the end of this memo, outline major provisions of current law governing the distribution of money wagered on horse racing, as well as the changes proposed in House Bill 5546:

Of the amounts wagered on live horse racing and simulcast races, a portion is retained by the race meeting licensee as "commission." House Bill 5546 would amend Section 2 to add a definition of "Net commission" to mean "*the money retained by the race meeting licensee from pari-mutuel wagering under this act after all winning wagers and fees and taxes paid by the race meeting licensee are deducted.*" The bill would also define:

"Money retained by the race meeting licensee from pari-mutuel wagering" to include "*any money paid by participants to engage in pari-mutuel wagering including a fee to participate in a pari-mutuel card game.*"

"Fees and taxes" to include "*breaks, simulcast fees, licensing fees, and other regulatory fees.*"

"Winning wagers" to include "*payments by the race meeting licensee in the form of cash, prizes, awards, or other things of value.*"

Under current law, the race meeting licensee's net commission is divided between the race meeting licensee and certified horsemen's organizations in accordance with Sections 17, 18, and 19 of the act.

Section 17 of the act prescribes the amount of allowable commission. Under current law the amount of commission is different for straight wagering (17%), and multiple wagering (not more than 28% or 35%, as authorized by the Racing Commissioner). House Bill 5546 would eliminate the different commission percentages and permit a race meeting licensee to retain as commission not more than 35% of all money wagered on or fees paid to participate in any pari-mutuel wagering and *pari-mutuel gaming activity* under the act.

House Bill 5546 would retain the provisions of current law regarding the distribution of commissions for live horse racing and simulcasting. Section 17 directs that unless otherwise provided by contract, 50% of the net commission from live horse racing be paid to the horsemen's purse pool at the racetrack at which the race was conducted. Section 18 provides that 40% of net commission from simulcast wagering go to the horsemen's simulcast purse pool established in Section 19.

House Bill 5546 would amend Section 18 by adding new subsection 18(6) to direct that 15% of a race meeting licensee's net commission from pari-mutuel wagering and pari-mutuel gaming activity *other than live horse racing and simulcasting* be paid to a horsemen's purse pool. The subsection further directs the distribution of horsemen's purse pool money under Section 18: 1/15th for marketing and promotion of live horse racing at the track that generated the money; 1/15th for capital improvements at the track which generated the money; 2/15th for purses and purse supplements for Michigan-bred 2- and 3-year-old horses that race at fairs and pari-mutuel racetracks in the state; the balance as provided under Section 13(2) of House Bill 5546 – a new subsection under the bill which describes authorized uses of horsemen's purse pool money.

Those testifying in support of House Bill 5546 have indicated that the bill is intended to provide additional revenue to participants in the horse racing industry – primarily holders of race meeting licenses, race horse owners, and race horse breeders. Those groups could receive additional revenue to the extent that the bill authorized, and race meeting licensees successfully established, pari-mutuel wagering on other pari-mutuel gaming activities beyond live horse racing and simulcast racing. Nothing in the bill would appear to cause an increase in revenue directly generated from horse racing or simulcasting of horse races.

State Taxes on Wagering/Fiscal Impact

The Horse Racing Act of 1995 eliminated the previous state tax on *live horse racing* wagering and established the current 3.5% tax on *simulcast racing* wagers. That tax, established in Section 22 of the Horse Racing Act of 1995, is estimated to generate \$4.6 million in FY 2011-12 for credit to the state-restricted Agriculture Equine Industry Development Fund (AEIDF).

Current year (FY 2011-12) appropriations from the AEIDF are follows: \$2.3 million in the General Government budget for regulatory activities of the Racing Commission within the Michigan Gaming Control Board and related information technology costs; \$1.0 million in the Agriculture and Rural Development budget for laboratory, information technology, and administrative costs related to horse racing programs; \$2.8 million in the Agriculture and Rural Development budget for horse racing grants and purse supplements.

House Bill 5546 as introduced would have eliminated the 3.5% tax on simulcast wagers and replaced it with a 16% tax on race meeting licensee simulcast race *commissions*. The H-1 substitute as reported from committee retains the current basis of taxation – 3.5% on interstate and intertrack simulcast wagers. With regard to the 3.5% tax on simulcast wagering, the bill would retain the current earmark of tax revenue for the AEIDF. To the extent that the H-1 substitute does not change the current 3.5% tax on simulcast wagering, there would be no apparent impact on AEIDF revenue.

House Bill 5546 (H-1) would also provide for a 15% tax on race meeting licensee commissions on other forms of pari-mutuel gaming authorized under the bill – forms of pari-mutuel wagering in addition to live horse racing and simulcasting currently authorized.

With regard to the 15% tax on commissions on other forms of pari-mutuel gaming authorized by the bill, House Bill 5546 would earmark the revenue as follows:

- 3/4ths to the state General Fund
- 1/8th to the city, township, or village in which the race meeting licensee conducts race meetings at a licensed track, and
- 1/8th to the county in which the race meeting licensee conducts race meetings at a licensed track.

The amount of additional state and local revenue that might be generated from pari-mutuel wagering that would be authorized by the bill cannot be reasonably estimated at this time. The amount of state General Fund and local revenue which might be generated from the 15% tax on commissions on other forms of pari-mutuel gaming authorized by the bill would depend on what forms of pari-mutuel gaming were actually established under authority of the bill, the amounts wagered on those other forms of pari-mutuel games, and the related licensee commissions.

The distribution of money wagered at race tracks, including state taxes, under current law and as proposed under House Bill 5546, is shown in the table below.

Context for Legal Gambling in Michigan

There are four major forms of legal gambling in Michigan: gaming at three Detroit Casinos, gaming at Indian Tribal Casinos, the State Lottery, and Horse Racing. The net amount wagered on all four major types of legal gambling in Michigan totaled over \$3.8 billion in 2011. The \$3.8 billion figure represents a \$1.0 billion increase from 2002. A ten-year history of wagering in Michigan for these four forms of legal gambling is shown in the table at the end of this memo.

The \$3.8 billion "net wagering" amount represents the total amount wagered on the four major forms of legal gambling, less the amount paid out to successful wagerers. From the perspective of the gaming industry, including the State of Michigan with respect to the State Lottery, the net wagering amount represents what might be called "gross margin on sales" in a traditional business. It is the amount of gross revenue, less cost of sales (payments to winning wagerers) but before other business costs, including commissions and taxes, are deducted. From the consumer's (wagerer's) perspective, net wagering is the amount spent gambling after deducting winnings.

Horse Racing Law of 1995			
Distribution of Wagering Money - after payment of winning tickets			
	Current Law	House Bill 5546 (H-1)	Notes
Commissions			
Commission - straight wager	17%		Section 17(3)
Commission - multiple wager	not more than 28%		
Commission - multiple wager	not more than 35% if authorized by racing commissioner		
Commission - all pari-mutuel wagers		not more than 35%	"Commission" is defined in Section 2n. "Commission" defined in Section 22(6) for purposes of state tax.
Purse Pools			
Purse Pool - Live Horse Racing	50% of <u>all</u> commissions from Live Horse Racing to Horsemen's Organization unless otherwise provided by contract. Paid to the horsemen's purse pool at the racetrack where the live horse racing was conducted.	50% of <u>net</u> commissions from Live Horse Racing to Horsemen's Organization unless otherwise provided by contract. Paid to the horsemen's purse pool at the racetrack where the live horse racing was conducted.	Section 17(3) of current law Section 17(4) of House Bill 5546
Purse Pool - Simulcast	40% of <u>net</u> commission from Simulcasting to Horsemen's Organization after taxes and fees.	40% of <u>net</u> commission from Simulcasting to Horsemen's Organization after taxes and fees.	Section 18
Purse Pool - Other Pari-Mutuel Wagering	N/A	15% of Commission from Pari-mutuel Wagering and Pari-Mutuel Gaming Activities Other than Live Horse Racing or Simulcasting to Horsemen's Organization. 1/15th promotion of live horse racing 1/15th for track capital improvements 2/15th for Michigan bred purse supplements 1/15th for breeders awards Balance according to Section 13(2)	Section 18(6) of House Bill 5546
Breaks	To city/township	To city/township	"Breaks" are the amount computed after rounding winning tickets to the nearest five or ten cent increment as provided in the act. Breaks are paid to city or township in which race track is located..
Section 17(4) and 17(4) current law. Section 17(6) and 17(7) of House Bill 5546.			
Licensing fees			
Racing track licensing fee	\$1,000.00 if located in a city; \$200.00 if outside a city area	\$1,000.00	Section 22
Occupational license fees	\$10 minimum to \$100 maximum	\$10 minimum to \$100 maximum	Section 16
Wagering Tax and Distribution			
State Tax - Live Horse	N/A	N/A	
State Tax - Simulcast	3.5% of wagers to AEIDF	3.5% of wagers to AEIDF	Section 22
State Tax - Other Pari-Mutuel Wagering	N/A	15% of commissions 3/4th to state GF/GP 1/8th to city/township/village 1/8th to county	Section 22

Net Wagering in Michigan 2002 Through 2011							
Year	Wagering on Horseracing			Net Wagering on Other Gaming			Total Net Wagering
	Wagering Total	Winning Tickets	Net ¹	Detroit Casinos ⁽²⁾	Indian Gaming ⁽³⁾	State Lottery ⁽⁴⁾	
2002	365,242,300	281,930,600	\$83,311,700	1,125,143,500	825,795,600	793,103,000	\$2,827,353,800
2003	346,578,000	267,366,800	\$79,211,200	1,130,201,900	853,007,600	781,894,000	\$2,844,314,700
2004	337,473,500	260,526,900	\$76,946,600	1,189,264,400	858,675,200	874,227,000	\$2,999,113,200
2005	309,772,500	240,325,200	\$69,447,300	1,228,543,900	877,020,200	907,485,000	\$3,082,496,400
2006	281,192,800	218,243,100	\$62,949,700	1,303,302,800	883,186,200	944,193,000	\$3,193,631,700
2007	260,963,100	200,802,600	\$60,160,500	1,335,015,900	871,403,800	1,013,516,000	\$3,280,096,200
2008	231,226,300	177,348,200	\$53,878,100	1,359,584,600	1,166,421,400	1,006,857,000	\$3,586,741,100
2009	203,338,700	155,043,800	\$48,294,900	1,339,479,300	1,203,663,400	969,794,000	\$3,561,231,600
2010	169,603,700	129,800,700	\$39,803,000	1,377,929,100	1,310,662,300	977,603,000	\$3,705,997,400
2011	144,931,600	110,477,300	\$34,454,300	1,424,445,500	1,421,850,450	995,628,566	\$3,876,378,816

Notes:

(1) Net Wagering on horse racing represents total wagering on horse racing less total paid to winning tickets. The net wagering amount is divided between the horse race meeting licensee commission, horsemen's organization purses, and state taxes.

(2) The amounts shown for Detroit Casinos represents adjusted gross receipts; i.e. gross receipts less winnings paid to wagerers. "Adjusted gross receipts" is the base on which the 19% Casino Wagering Tax is assessed.

(3) The amounts shown for Indian Gaming were computed based on the 2% payments to local units of government, established by terms of compacts between Native American tribes and the State of Michigan. The 2% is calculated on net win from electronic games and does not include table games.

(4) The amounts shown for State Lottery represent total State Lottery sales less amounts paid in prizes.

Sources: Annual Reports, Office of Racing Commissioner; Annual Reports, Michigan Gaming Control Board; Michigan Department of Treasury reports on 2% Payments to Local Units of Government; Annual Reports, Bureau of State Lottery. With the exception of the Lottery figures, which are based on state fiscal year data, years represent calendar years.