

MEMORANDUM



DATE: October 5, 2022
TO: Interested Parties
FROM: William E. Hamilton
RE: **Senate Bill 396** (S-1) as Passed by the Senate – Legislative Analysis Update

This memo updates the House Fiscal Agency (HFA) analysis of Senate Bill 396 (S-1), as passed by the Senate, dated December 13, 2021.

As noted in the original analysis, Senate Bill 396 can be described as having two broad subjects: 1) the legalization and regulation of wagering on the results of horse races run in the past, i.e., historical horse racing, and 2) other revisions of the Horse Racing Law not directly related to wagering on historical horse races, including revisions dealing with the Agriculture Equine Industry Development Fund (AEIDF). This memo provides additional information on AEIDF revenue and distribution, including updated revenue figures and analysis of the potential fiscal impacts of Senate Bill 396.

AEIDF Revenue Sources and Distribution

The 1995 recodification of Michigan's horse racing laws, the Horse Racing Law of 1995, eliminated the tax on live horse race wagering and established a 3.5% tax on simulcast wagering. The Horse Racing Law of 1995 also created the AEIDF as a state restricted fund within the Department of Treasury and directed revenue from the simulcast wagering tax for credit to the AEIDF. Section 20 of the Horse Racing Law directed the use of AEIDF revenue for various equine-related programs, as appropriated.

Although the Horse Racing Law of 1995 established and earmarked other fees for credit to the AEIDF, including revenue from various licensing fees and uncashed winning tickets ("outs"), revenue from the simulcast wagering tax revenue was by far the largest AEIDF revenue source, representing at least 90% of baseline AEIDF revenue.

Revenue from the simulcast wagering tax declined steadily from shortly after it was first established in 1995 through 2019. Simulcast wagering tax revenue peaked at \$12.8 million in 1998 and declined to \$2.1 million in 2019, the last full year prior to the COVID-19 pandemic. Revenue from the tax was \$954,500 in 2020 and \$1.9 million in 2021.¹

For the 2021-2022 fiscal year, revenue from the simulcast wagering tax was estimated at \$3.0 million.

Beginning in FY 2019-20, AEIDF revenue was supplemented with revenue from a tax on Advance Deposit Wagering (ADW), a method for wagering on the results of horse races through a computer or smart phone application that was first authorized in Michigan through 2019 amendments to the Horse Racing Law (2019 PA 153).² The tax was established at 1% of wagers processed through ADW licensed third-party facilitators. Revenue from this tax for credit to the AEIDF totaled \$579,500 in FY 2019-20 and \$297,600 in FY 2020-21.³

¹ These figures are on a calendar year basis from Office of Racing Commissioner/Michigan Gaming Control Board (MGCB) annual reports.

² <http://legislature.mi.gov/doc.aspx?2019-HB-4310>

³ 2019 PA 153 also earmarked revenue from the tax on ADW wagers: 90% to the AEIDF and 10% to the Horse Racing Advisory Commission created under section 6a of the act. In practice, 100% of the tax on ADW is credited to the AEIDF; the Horse Racing Advisory Commission earmark is then appropriated from the AEIDF.

In addition to tax and fee revenue related to horse racing and authorized under the Horse Racing Law, the AEIDF has also received revenue from earmarks of state revenue sources unrelated to horse racing.

The Lawful Internet Gaming Act (2019 PA 152) and the Lawful Sports Betting Act (2019 PA 149) both earmarked a portion of revenue from the taxes established under those acts to the AEIDF.⁴ Revenue from those earmarks was first credited to the AEIDF in FY 2020-21.

In addition to the ongoing statutory revenue earmarks noted above, the FY 2021-22 budget for the Michigan Department of Agriculture and Rural Development (MDARD) included a one-time \$3.2 million transfer from the state general fund to the AEIDF.⁵

The \$3.2 million general fund appropriation was governed by the following boilerplate section:

Sec. 1002. From the funds appropriated in part 1 for the one-time agriculture equine industry development fund, \$3,200,000.00 shall be deposited into the Michigan agriculture equine industry development fund created under section 320 [sic] of the horse racing law of 1995, 1995 PA 279, MCL 431.320. All funds in the agriculture equine industry development fund are appropriated and available for expenditure under section 320 [sic] of the horse racing law of 1995, 1995 PA 279, MCL 431.320.

The table at the end of this memo shows actual AEIDF revenue by source from FY 2017-18 through FY 2020-21 (complete fiscal year totals) and FY 2021-22 through **September 26, 2022**. Average AEIDF revenue for the three fiscal years FY 2017-18 through FY 2019-20 was \$2.4 million. Revenue increased to \$6.3 million in FY 2020-21, primarily due to the earmark of \$3.0 million in Lawful Internet Gaming Act revenue.

The table shows FY 2021-22 AEIDF revenue through **September 26, 2022** of **\$9.6 million**. MDARD has estimated that final FY 2021-22 AEIDF revenue from all sources will total **\$9.8 million**.

Fiscal Impact – AEIDF Revenue and Distribution Impacts.

The December 2021 HFA analysis of Senate Bill 396 states that the establishment of historical horse racing at licensed race meetings in Michigan as provided in the bill could result in additional state tax revenue. Of the revenue from the bill's proposed 19% tax on historical horse racing adjusted gross receipts, the bill would earmark 25% to the AEIDF. The amount of actual gross tax revenue would depend on a number of factors, including the number of race meeting licensees,⁶ the number of historical horse race terminals installed and operating at licensed race tracks, and adjusted gross receipts generated from wagers made at those terminals. Because of these factors, the amount of gross revenue from the tax could not be readily estimated. Accordingly, the amount of historical horse race wagering tax revenue for credit to the AEIDF cannot be readily estimated.

Although the bill would earmark 25% of revenue generated from the tax on historical horse racing wagering to the AEIDF, a state restricted fund, provisions in the bill establishing a ceiling on the AEIDF, a *maximum allocation amount*, could result in the transfer of AEIDF revenue in excess of the ceiling from the AEIDF to private parties. A transfer of AEIDF revenue to private parties may occur in FY 2021-22, as described below.

⁴ <http://legislature.mi.gov/doc.aspx?mcl-Act-152-of-2019>

<http://legislature.mi.gov/doc.aspx?mcl-act-149-of-2019>

⁵ Article 1 of 2021 PA 87, <http://legislature.mi.gov/doc.aspx?2021-SB-0082>

⁶ There is currently only one race meeting licensee in Michigan, Northville Downs. The bill would limit the number of race meeting licenses that the MGCB could issue to three.

AEIDF Revenue in Excess of \$8.0 million

As noted above, the 2019 amendments to the Horse Racing Law, 2019 PA 153, authorized and regulated ADW. The amending legislation also added new subsection 19 to section 20 to establish a ceiling on the AEIDF. The subsection reads as follows:

Section 20(19): "If the amount allocated to the Michigan agriculture equine industry development fund under this act or any other source exceeds \$8,000,000.00 in a fiscal year, the amount in excess of \$8,000,000.00 must be allocated to the pari-mutuel horse racing disbursement account under section 19."

The reference to the "pari-mutuel horse racing disbursement account under section 19" is actually to section 19(2), a subsection also added in 2019 PA 153. Section 19(2) governs the distribution of the net commission from ADW: first to the pari-mutuel horse racing disbursement account, and then from that account, 50% to be divided equally to each certified horsemen's organization (CHO) and 50% to be divided equally to each track licensee. The subsection was silent regarding the use of the funds by either the CHO or the track licensee. That is to say, unlike the provisions of section 19(1), which required that the CHO share of the simulcast purse account be used for "purses for live horse races at a licensed race meeting in this state," the use of the net commission from ADW was without restriction; the recipients could use the funds for any purpose.

Section 19(2) states that the 50% share of the pari-mutuel horse racing disbursement account to be distributed to the CHOs is to be divided equally to *each* certified horsemen's organization and that the 50% share of the pari-mutuel horse racing disbursement account to be distributed to track licensees is to be divided equally to *each* track licensee. However, since April 2018, when Hazel Park racetrack closed and voluntarily relinquished its race meeting license and track license, there has been only one valid track license in Michigan, Northville Downs, and one recognized CHO, the Michigan Harness Horsemen's Association (MHHA). As a result, the provisions of section 19(2) appear to affect only two parties: one track licensee, the owners of Northville Downs, and one CHO, the MHHA.

To date, the provisions of section 19 have only affected the distribution of private resources: section 19(1) governs the net commission from simulcast wagering, and section 19(2) governs the net commission from ADW. However, the provisions of section 19(2) will come into play with respect to public resources in FY 2021-22 when the amount "allocated to" the AEIDF from all sources will exceed \$8.0 million.

Implementation of Section 20(19) – Transfer of AEIDF Revenue in Excess of \$8.0 million

As noted above, section 20(19) of the Horse Racing Law states: "If the amount allocated to the Michigan agriculture equine industry development fund under this act or any other source exceeds \$8,000,000.00 in a fiscal year, the amount in excess of \$8,000,000.00 must be allocated to the pari-mutuel horse racing disbursement account under section 19."

In a September 15, 2022 memo, MDARD indicated that the phrase "amount allocated to" means *revenue* and that the redistribution provisions of section 20(19) will be triggered in FY 2021-22 when AEIDF revenue from all sources, including the \$3.2 million general fund transfer, will exceed \$8.0 million.

MDARD has indicated that sometime after the close of the 2021-22 fiscal year, after all AEIDF revenue has been recorded, the department will effect the transfer of AEIDF revenue in excess of \$8.0 million to the pari-mutuel horse racing disbursement account. MDARD has estimated that final FY 2021-22 AEIDF revenue will be \$9.8 million. Based on the MDARD estimate, the amount of AEIDF revenue to be transferred to the pari-mutuel horse racing disbursement account at the close of the 2021-22 fiscal year would be \$1.8 million.

If actual revenue credited to the AEIDF fund in FY 2021-22 were greater than the \$9.8 million estimate, the amount to be transferred to the pari-mutuel horse racing disbursement account would also be greater than the \$1.8 million estimate.

It's not clear how this transfer would be recorded in the state accounting system. The proposed distribution is not a payment under a contract for goods or services provided, or a grant agreement to a public agency or local unit of government. The pari-mutuel horse racing disbursement account is not an account in the state accounting system.

Senate Bill 396 Impacts on AEIDF Revenue Ceilings

Senate Bill 396 would eliminate the hard \$8.0 million ceiling currently in section 20(19) and replace it with a variable ceiling, the *maximum allocation amount*. Under terms of the bill, the maximum allocation amount in the first year of implementation would likely be \$12.0 million. The bill would not change the other terms in section 20(19) related to the redistribution of excess funds or the mechanism for redistribution. Under provisions of the bill, if the *amount allocated to the AEIDF*, i.e., revenue, exceeded the *maximum allocation amount*, the excess amount would be allocated to the pari-mutuel horse racing disbursement account under section 19(2).

Horse Racing Advisory Commission

Under current provisions of the Horse Racing Law, revenue from the 1% tax on ADW gross wagers is earmarked: 90% to the AEIDF and 10% to the Horse Racing Advisory Commission created under section 6a of the act. In practice, 100% of the tax on ADW is credited to the AEIDF. The Horse Racing Advisory Commission earmark is then appropriated from the AEIDF.⁷

Similarly, Senate Bill 396 would earmark a portion of the 19% tax on historical horse racing adjusted gross receipts to the Horse Racing Advisory Commission. Specifically, the bill would earmark 4% of revenue from the 19% tax to the Horse Racing Advisory Commission to be expended as provided under section 6a(12)(d) for promotion and marketing of horse racing, for equine-related research, and for grants for equine-related support and aftercare and programs related to horse racing.

Because the amount of gross revenue from the proposed 19% tax on historical horse race wagering adjusted gross receipts cannot be readily estimated, neither can the amount of the 4% earmark to the Horse Racing Advisory Commission.

If the 4% earmark for the Horse Racing Advisory Commission is treated in the same way as the earmark of ADW tax revenue, revenue from the earmark would first be credited to the AEIDF and then the Horse Racing Advisory Commission earmark would be appropriated from AEIDF revenue. This treatment would increase AEIDF revenue and thus could affect the maximum allocation amount in a fiscal year.

The amounts appropriated for the Horse Racing Advisory Commission in MDARD budgets are as follows: FY 2020-21, \$190,000; FY 2021-22, \$125,000; FY 2022-23, \$125,000.

The December 13, 2021 HFA analysis of Senate Bill 396 stated that the Horse Racing Advisory Commission had met only twice since its creation, on January 20, 2017, and March 6, 2017. It was later determined that the Commission had actually met four additional times as of the analysis date: June 30, 2021; August 24, 2021; October 12, 2021; and November 9, 2021. Those meetings were not publicly noticed, and contemporaneous meeting minutes were not maintained. The Commission subsequently

⁷ The 2016 amendments to the Horse Racing Law, 2016 PA 271, included the establishment of the Horse Racing Advisory Commission in new section 6a. The 2019 amendments, 2019 PA 153, which authorized, regulated, and taxed ADW, also earmarked 10% of the revenue from the 1% tax on ADW gross wagers to the Horse Racing Advisory Commission.

met on December 14, 2021; January 11, 2022; March 1, 2022; and May 26, 2022. Only the May 26, 2022, meeting was noticed in accordance with the Open Meetings Act. At the May 26, 2022, meeting, the Commission approved minutes from the prior eight meetings.

The statute provides for a seven-member commission, appointed by the governor with the advice and consent of the Senate. However, there are only five members currently appointed and serving, and only five members are currently possible. The statute requires that two members be appointed from two different horse racetracks in the state, and two members from two different horse racing associations. There is currently only one licensed racetrack in the state and one recognized horse racing association.

Attachment

AGRICULTURE EQUINE INDUSTRY DEVELOPMENT FUND						
Revenue History						
					YTD	
					9/26/2022	
	FY 2017-18	FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22	
Simulcast Wagering Tax @ 3.5% ¹	2,819,418	2,269,885	1,370,087	2,748,783	2,639,726	
"Outs," licenses, fines, misc. ²	68,145	25,342	38,775	32,760	33,945	
Advance Deposit Wagering ³			579,527	297,574	131,590	
Lawful Sports Betting				269,819	579,220	
Internet Gambling Act				3,000,000	3,000,000	
AEIDF Revenue	\$2,887,563	\$2,295,227	\$1,988,389	\$6,348,936	\$6,384,481	
Civil Service Assessment	(448)	(600)	(361)	(323)	(21)	
Transfer to DCH, Problem Gambling						
GF/GP Transfer					3,200,000	
Net AEIDF Revenue	\$2,887,115	\$2,294,627	\$1,988,028	\$6,348,613	\$9,584,460	
1. Simulcast wagering tax established under Section 22 of the Horse Racing Law of 1995.						
2. Various license fees, fines, and other revenue sources established in the Horse Racing Law of 1995.						
3. Advance Deposit Wagering became effective in 2020.						
Source: Revenue reports from SIGMA reporting tools.						