COMMONWEALTH OF KENTUCKY
OFFICE OF THE GOVERNOR

STEVEN L. BESHEAR
GOVERNOR

700 CAPITOL AVENUE
SUITE 100
FRANKFORT, KY 40601
(502) 564-2611
FAX: (502) 564-2517

May 6, 2015

The Honorable Jacob J. Lew
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Secretary Lew:

On October 28, 2014, I wrote to you lending my support to a June 3, 2014, letter sent to you by a bipartisan group of seventeen Members of Congress. That letter asked the Treasury Department to issue "updated, authoritative guidance on how to calculate 'wagering proceeds' to ensure that the reporting and withholding of winnings from pari-mutuel betting is accurate and reflects the current state of wagering today." As I stated in my October 28 letter, I support this effort because such updated guidance is urgently needed to aid an industry of great importance to the economic well-being of the Commonwealth of Kentucky.

I understand that Assistant Treasury Secretary Mark J. Mazur recently met with Congressman John Yarmuth and representatives from the Thoroughbred racing and breeding industry in Washington D.C. I thank you for listening to and considering their concerns regarding the need for modernization of the federal regulations governing the taxation of pari-mutuel wagering.

I am especially appreciative of the Treasury Department's inclusion in published REG-132253-11 of a request for comments regarding amendment of the regulations under Treas. Reg. sec. 31.3402(q)-1 relating to withholding and reporting winning pari-mutuel wagers.

Enclosed is a copy of the public comments of the National Thoroughbred Racing Association which were recently filed in the docket on behalf of the Thoroughbred racing and breeding industry. I commend these comments to you for your review and consideration as this process moves forward.

Again, thank you working with the Thoroughbred racing and breeding industry, an industry that is very important to the Commonwealth of Kentucky, on ways to modernize the pari-mutuel wagering rules.

Sincerely,

Steven L. Beshear

Enclosure

cc: Assistant Secretary Mark J. Mazur

ADVOCACY • INTEGRITY • LEADERSHIP

April 16, 2015

DELIVERED VIA ELECTRONIC MAIL

Internal Revenue Service
Attn: CC:PA:LPD:PR (REG-132253-11)
1111 Constitution Avenue, N.W.
Room 5205
Washington, D.C. 20224
http://www.regulations.gov/

Re: Request for Comments on Pari-Mutuel Gambling in REG-132253-11

Dear Sir or Madam:

We are writing on behalf of the National Thoroughbred Racing Association (the "NTRA") in response to the invitation by the Department of the Treasury (the "Treasury") and the Internal Revenue Service (the "Service") published in REG-132253-11 for comments on amending the regulations under Treas. Reg. sec. 31.3402(q)-1 for pari-mutuel wagering.

The NTRA is a broad-based coalition representing all segments of the Thoroughbred horse racing industry, including more than 100 horse racing organizations and thousands of individual stakeholders consisting of horseplayers, racetrack operators, owners, breeders, trainers and affiliated horse racing organizations.

Horse racing has been a part of the United States economy for more than 300 years. Today, nearly 40 states are home to horse racing tracks and nearly every state has racehorse breeding farms. The horse racing industry generates $10 billion for the U.S. economy and is responsible for tens of thousands of jobs. In addition, pari-mutuel wagering on horse racing produces hundreds of millions of dollars in tax revenue for states and localities in which racetracks are located.

We understand Treasury and the Service intend to amend the regulations under Treas. Reg. sec. 31.3402(q)-1 ("Section 31.3402(q)-1") in a manner consistent with the proposed regulations published in REG-132253-11.[1] We greatly appreciate the opportunity to comment on Section 31.3402(q)-1 in connection with the proposed regulation project. Section 31.3402(q)-1 needs to

[1] 80 Fed. Reg. 11600 (March 4, 2015). According to the preamble, the proposed regulations in REG-132253-11 were published because the existing regulations for reporting winnings from bingo, keno, and slot machines need to be updated.

be modernized to ensure that both the withholding and reporting of winnings from pari-mutuel wagering accurately and fairly reflect the realities of wagering today. In particular, for the reasons discussed below, we respectfully request that Treasury and the Service amend Section 31.3402(q)-1 to make it clear that the definition of the "amount of the wager" reflects the total amount wagered by a bettor into a specific pari-mutuel pool for purposes of determining whether any wagering proceeds paid to the bettor from that pari-mutuel pool are subject to withholding and reporting.

1. What is pari-mutuel wagering?

Payoffs on winning wagers on U.S. horse races are determined through what is known as pari-mutuel wagering, a French term for betting "amongst ourselves." Because the players themselves establish the odds and payouts, the pari-mutuel aspect of wagering on horse racing differs from casino wagering, where the winning wagers are determined through fixed odds.

For most of its history up to the early 1980s, pari-mutuel horse racing faced very little competition from state lotteries or other forms of gambling. During that earlier period, the vast majority of all wagers were one of three "straight" wagers – win, place or show. A "win" wager is one in which a single horse is picked to finish first. A wager that a single horse will finish first or second is a "place" wager. And a wager that a single horse will finish first, second or third is a "show" wager. The current withholding and reporting rules were developed during this earlier period when few, if any, straight wagers resulted in a winning payoff 300 times as large as the amount wagered – a key threshold for tax withholding and reporting purposes. But as will be explained below, the pari-mutuel wagering environment has evolved and the tax withholding and reporting rules need to be modernized to reflect today's environment.

The industry's historic reliance on straight wagers changed in the late 1980s and 1990s as better technology and increases in state lottery and casino competition drove innovations in pari-mutuel wagering, including the development of multi-race or multi-horse wagers also known as "exotic" wagers. These wagering innovations offered the prospect for larger payoffs. First came the development of multi-horse exotic wagers like the exacta (horses finishing first and second in the exact order) and the trifecta (horses finishing first, second and third in the exact order). Then came the multi-race wagers such as the Pick 3 (picking winners in three consecutive races) and the Pick 6 (picking winners in six consecutive races).

Today, with a near-endless variety of multi-horse and multi-race bets, horse racing fans have steadily migrated away from straight win, place, and show bets toward exotic wagers like the exacta, the trifecta and the Pick 6 because they offer the prospect of larger odds and bigger pay-offs. To encourage the migration to exotic bet types, tracks offer exotic bettors the unique ability to "box" his or her wagers. A "boxed" wager is one in which the pari-mutuel wager includes all possible combinations of a group of horses in the same race (e.g., a three-horse exacta box where three horses are selected to finish first and second in any combination and order of finish). Bettors also can "key" a single horse in a single race by betting that horse in one position (e.g., to win) with all possible combinations of other selected horses (e.g., a trifecta key where a single horse is selected to win and other horses are selected to finish second and third in any order of finish). There also is a bet type known as a "wheel" which involves multiple horses in multiple

combinations in multiple races (e.g., a Daily Double wheel where a single horse is selected to win in the first race with every horse selected in the second race).

The amount invested by bettors in these modern exotic wagers, especially those that are boxed, keyed or wheeled, is substantially more than traditional straight wagers, but bettors are willing to increase the amount of their wagers because such wagers cover more combinations, thereby increasing their chances of winning. It is this increased cost of the modern exotic wagers that necessitates the updated regulations we are seeking. This is because the full cost of exotic wagers is not currently being considered when applying the 300:1 ratio to such wagers under the current regulations.

And this antiquated policy is costing the horse racing industry a lot. Here is how one frequent bettor described the situation that currently exists for horseplayers in our business:

> This policy [of considering only the cost of the single winning ticket] is costing the racing industry tens, if not hundreds, of millions of dollars every year by taking money out of circulation (i.e. customers' pockets) that otherwise would have been repeatedly re-bet, and by driving high-end players away from the game entirely. Anyone who routinely invests in exotic wagers will be overwhelmed by withholdings. One successful pick six player testified a few years ago that his annual withholdings were roughly four times his actual annual profits and that he had needed to open lines of credit against his home just to have enough cash to continue playing until some refunds eventually arrived. (And for several technical tax reasons, those refunds never get you squared up because of glitches involving the alternative minimum tax and the deductibility of losses on state tax returns.) Steven Crist, *Daily Racing Form*, June 19, 2014.

One particular point not reflected in the current regulations is the fact that in spite of all these sometimes complicated combinations, it is still the case that pari-mutuel wagering requires a separate pool for every type of bet that is made on a race or series of races. For example, every straight bet, such as a win bet, made in each race goes into the win pool for that race, regardless of which horse is selected. And there also is a separate pool in each race for each exotic bet, such as an exacta bet, regardless of the horses or the order of finish selected and even if that exacta bet is boxed. There also is a separate pool for each exotic bet type involving multiple horses in selected races such as the Pick 3. Thus, when a person holds a winning Pick 3 ticket, that person shares all of the money bet into that particular pool (less a "takeout" for certain expenses, taxes and commissions) with everyone else holding a winning Pick 3 ticket or tickets in that pool. Yet, for tax withholding and tax reporting, guidance published by Treasury and the Service states that for purposes of determining the ratio of wagering proceeds to the amount of the wager, the bettor is only allowed to consider the cost of a single winning combination. Simple fairness demands that if a bettor will potentially be taxed on his or her share of all money wagered into a pool (net of commission), that bettor also should be allowed to include all the money he or she bet into that pool for purposes of calculating the amount he or she wagered. Unfortunately, that is not currently the case.

Instead, bettors are subjected to a set of rules that appears to be inconsistent with basic tax policy. Imagine buying shares of stock in a company and upon the sale of that stock, being told

that your basis for tax purposes is the original cost of a single share of that stock, not the entire cost of your original investment in that company. This is actually the result under the current rules for pari-mutuel bettors. There is no logical basis for this disparity in treatment.

2. Current Withholding and Reporting Requirements

a. Withholding rules

Internal Revenue Code ("IRC") section 3402(q)(1) provides that "[e]very person … making any payment of winnings which are subject to withholding shall deduct and withhold from such payment a tax in an amount equal to the product of the third lowest rate of tax applicable under section 1(c) and such payment." For this purpose, "winnings which are subject to withholding" means gross proceeds of more than $5,000 from a wagering transaction in a pari-mutuel pool with respect to horse races, dog races, or jai alai, if the amount of such proceeds is at least 300 times as large as the amount of the wager.[2] Importantly, the amount of proceeds from a wager is determined by reducing the amount received by the "amount of the wager."[3] Likewise, for withholding to occur the amount of such proceeds also must be a least 300 times as large as the "amount of the wager." The IRC does not provide a definition of the "amount of the wager."

Section 31.3402(q)-1(c)(1)(ii) does address when amounts paid with respect to identical wagers are treated as paid with respect to a single wager for purposes of calculating the amount of proceeds from a wager. In this regard, the regulation states –

> Amounts paid after December 31, 1983, with respect to identical wagers are treated as paid with respect to a single wager for purposes of calculating the amount of proceeds from a wager. For example, amounts paid on two bets placed in a parimutuel pool on a particular horse to win a particular race are treated as paid with respect to the same wager. However, those two bets would not be identical were one "to win" and the other "to place," or if the bets were placed in different parimutuel pools, e.g., a pool conducted by the racetrack and a separate pool conducted by an off-track betting establishment in which the wagers are not pooled with those placed at the track.

b. Reporting rule

Section 31.3402(q)-1(f)(1) provides that every person making a payment of winnings for which withholding is required must file a Form W-2G with the Service on or before February 28 (March 31, if filed electronically) of the calendar year following the calendar year in which the payment of winnings is made and must furnish a copy of the Form to the payee. For reporting purposes, the amount of reportable gambling winnings is the amount paid with respect to the amount of the wager reduced, at the option of the payor,

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[2] IRC section 3402(q)(3)(C)(ii).

[3] IRC section 3402(q)(4)(A).

by the "amount of the wager."[4] In addition, a payment of gambling winnings (other than winnings from bingo, keno, or slot machines) is reportable only if the amount paid with respect to the wager (after reducing the amount paid by "the amount of the wager") is $600 or more and if the proceeds are at least 300 times as large as "the amount of the wager."[5]

c. *Application of the current requirements*

Currently, the Instructions for Forms W-2G and 5754 (the "Instructions") treat multiple wagers in the same pari-mutuel pool as separate wagers. The Instructions state as follows:

> For multiple wagers sold on one ticket, such as the $12 box bet on a Big Triple or Trifecta, the wager is considered as six $2 bets and not one $12 bet for purposes of computing the amount to be reported or withheld.

The Instructions ignore the fact that even though the $12 box ticket represented the placing of a $2 bet on each of six different combinations, all of those wagered amounts were part of a single pari-mutuel pool, i.e. either the Big Triple pool (more commonly referred to today as the Pick 3 pool) or the Trifecta pool, depending on the bet.[6]

3. Issues Created by the Current Withholding and Reporting Rules

As discussed above, for both withholding and reporting purposes, to determine the amount of proceeds from a wager, the amount received is reduced by the "amount of the wager" and to determine if the 300:1 ratio has been met, the proceeds from a wager also must be at least 300 times as large as "the amount of the wager." However, since the IRC does not provide a definition of "amount of the wager" Treasury should use its regulatory authority to issue revised and updated regulations to define "amount of the wager" when multiple bets are placed in the same pool. As noted above, the current regulations provide limited guidance on what can constitute the "amount of the wager" by addressing the treatment of identical wagers. However, Treasury and the Service should provide a more comprehensive definition of "amount of the wager" to include the total amount wagered by a bettor into a specific pari-mutuel pool to reflect the current realities of wagering. In doing so, Treasury and the Service also should delete the discussion in the Instructions regarding the treatment of multiple wagers because the Instructions ignore the fact that even though the $12 box ticket represented the placing of a $2 bet on each of six different combinations, all of those wagered amounts were part of a single pari-mutuel pool.

By not including all amounts wagered by a taxpayer into the same pool for a particular bet as the "amount of the wager," the incidence of withholding and reporting have greatly increased with the growth of exotic wagering. This rapid rise in withholding and reporting of winning wagers has a detrimental effect on pari-mutuel wagering, pulling money out of circulation and

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[4] Treas. Reg. sec. 31.3406(g)-2(d)(2).

[5] *See* Treas. Reg. sec. 31.3406(g)-2(d)(3); *see also* 2015 Instructions for Forms W-2G and 5754.

[6] The Service adopted a similar position in PLR 7823066 (March 13, 1978).

depressing pari-mutuel wagering at a time when the industry needs more exotic wagering, not less, to remain competitive in a rapidly changing gaming and wagering environment.

What the pari-mutuel wagering industry needs is a modern and equitable approach to the determination of the "amount of the wager." Both prongs of the withholding and reporting rules applicable to pari-mutuel wagers – the amount of the proceeds from a wager for purposes of determining the applicable threshold (amount received less the "amount of the wager") and the 300:1 ratio (amount of the proceeds from a wager must be at least 300 times as large as "the amount of the wager") – are greatly affected by the way in which Treasury and the Service currently define "the amount of the wager" in the Instructions. Certainly, pari-mutuel wagering should be subject to fair and accurate taxation but the current antiquated methodology for determining "the amount of the wager" undermines our business because it fails to take into account the economic reality that our bettors are staking more money to win bigger payoffs. Instead, the current methodology subjects more bettors to tax withholding which mainly serves to pull money out of circulation during the course of a race day at a time when that money is needed most by a winning bettor who will likely re-bet the winning proceeds many times over. Such re-betting benefits all associated with pari-mutuel horse racing including the federal government which in the long run will gain more from increased wagering than from over-withholding from horse racing's bettors.

When the current regulations relating to reporting and withholding were enacted in the 1970s, approximately 90 percent of all pari-mutuel wagering occurred on straight win, place, and show wagers. Fast forward to today when approximately 67 percent of all pari-mutuel wagering now occurs on exotic wagers. For example, in 2014, the average $1.00 superfecta wager in which a customer tries to select the top four finishers in a single race returned $1,684.23. The average $1.00 trifecta wager in which a customer tries to select the top three finishers in a single race returned $242.47. That said, given the vast number of potential combinations involved, it is undoubtedly the case that each of the individuals holding those winning superfecta and trifecta tickets wagered far more into that pool than the $1.00 cost of the winning bet.

As illustrated by the examples that follow, the current practice of not treating all wagers made by a bettor into the same pool as the "amount of the wager" produces pari-mutuel winnings that are exaggerated and unfairness can often be the result.

Example Under Current Regulations

Assume an individual decided to make a Trifecta wager (selecting the first-, second-, and third-place finishers in a race, in exact order). To improve his or her chances of winning, the individual selects a group of seven horses in the race and requests a "Trifecta box." As explained above, by boxing the bet, a bettor wins if any three of the seven horses finishes one-two-three (in any order). A seven-horse Trifecta box involves 210 different mathematical combinations. If the bettor bets $20 on each combination, the total amount wagered is $4,200 ($20 x 210). After the race, the bettor held a winning ticket that paid $6,100 (which is odds of 304-to-1 under the Instructions which limit the amount wagered to only the single $20 combination).

In accordance with the Instructions, the racetrack would withhold $1,520 because the rules treat the $20 paid for the ***one*** winning combination as the ***only*** amount wagered. The withholding is computed as follows:

$6,100	Proceeds from wager
($20)	Amount wagered
$6,080	Winnings
x 25%	Automatic withholding
$1,520	Withholding tax

The individual, however, has really only won $1,900 ($6,100 winnings less $4,200 wagered). Consequently, after the withholding tax was taken out, the person was left with a net of only $380, making the withholding rate 80 percent of the actual winnings.[7]

The racetrack also would report $6,080 in winnings on which tax would be owed by the individual unless the person can successfully navigate the challenges outlined in footnote 7.

Example Under Proposed Change

The pay-off computations for the winning Trifecta outlined in the example above are changed by defining the "amount of the wager" as the actual dollars wagered by that individual into the Trifecta pool for that race. The wager in this scenario results in no withholding as the twin tests of winnings of more than $5,000 and odds of at least 300-to-1 or more are not met:

$6,100	Proceeds from wager
$4,200	Amount wagered
$1,900	Winnings

In this example, the winning payout of $1,900 is less than the $5,000 threshold and the proceeds from the wager ($6,100) are far less than 300 times the amount wagered ($4,200).

Similarly, in this example, there would be no tax reporting because even though the winnings exceed the $600 threshold for reporting, those winnings are not 300 times as large as the $4,200 amount wagered.

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[7] If the individual itemized when filing his or her tax return, the individual may be able to get back the over-withholding by claiming the balance of what was bet on the Trifecta as a miscellaneous itemized deduction on his or her tax return unless the individual is subject to the Alternative Minimum Tax (AMT). Of course, this would not be available to an individual who does not itemize when filing his or her return. Also, many states limit the gross amount of itemized deductions for state tax purposes, even when these deductions are legitimate claims of loss against profits.

4. Policy Reasons for Updating the Regulation

Today approximately 30 million Americans wager on pari-mutuel horse racing each year. Due to the growing popularity of exotic wagering across all fan groups, virtually any horseplayer may find himself or herself standing in the "IRS line" at a racetrack. Every one of horse racing's 1,200+ wagering service sites must calculate, track, withhold and forward to the Service any federal tax due on winnings of more than $5,000. This process requires the expenditure of thousands of man-hours processing withholding obligations and producing Forms W-2G.

In addition to the time spent processing withholding and reporting, the current withholding rules reduce revenues and economic benefits generated by the racetrack. Statistics show that each pari-mutuel dollar returned to the bettor in the form of winnings is re-bet seven times throughout the course of a day. Tax withholding reduces the amount of re-betting, which not only has an effect on the bettor and the track, but also serves to reduce the collection of additional tax revenues that are paid by each racetrack operator on its net revenues.

5. Proposed Change

In light of the foregoing, we respectfully request that Treasury use its regulatory authority to revise and update Section 31.3402(q)-1 to reflect innovations and changes in today's modern pari-mutuel wagering strategies by providing a definition of "amount of the wager" that includes the total amount wagered by a bettor into a specific pari-mutuel pool for purposes of determining whether wagering proceeds from that specific pari-mutuel pool are subject to withholding and reporting. We further request that Treasury and the Service revise the discussion in the Instructions regarding the treatment of multiple wagers in a manner that includes the total amount wagered by a bettor into a specific pari-mutuel pool when determining whether wagering proceeds are subject to withholding.

6. Summary

The current regulations relating to pari-mutuel reporting and withholding need to be updated for the following reasons:

- In the absence of a specific regulation concerning the definition of the "amount of the wager," the horse industry is forced to rely on the Instructions for Forms W-2G and 5754. The guidance provided by these Instructions does not reflect today's wagering strategies in which the vast majority of wagers are multi-horse and multi-race exotic bet types but instead reflects a bygone era when almost all wagers were straight win, place or show bets that had virtually no chance of exceeding the 300:1 ratio of wagering proceeds to "the amount of the wager;"

- The Instructions assume that a bettor has won more than he or she has actually won based on a calculation of "the amount of the wager" that ignores the actual investment in a single pari-mutuel pool;

- Due to this outdated and unfair method of calculating the "amount of the wager," excessive withholding and reporting are taking bettors' winnings out of circulation – money that otherwise would be repeatedly re-bet;

- Undue withholding and reporting of winnings and the resulting lack of re-betting, depresses pari-mutuel wagering and the benefits that wagering supplies to all stakeholders including federal and state governments, which derive significant tax revenue from pari-mutuel wagering, as well as the nationwide agri-business that pari-mutuel wagering supports;

- An update to the regulations to reflect today's pari-mutuel wagering strategies will result in more accurate reporting and withholding by taxpayers and is consistent with IRC Section 3402(q) and basic tax policy; and

- Modernization will reduce burdensome and needless paperwork system-wide.

* * * *

We appreciate this opportunity to comment on Section 31.3402(q)-1 in connection with the proposed regulation project (REG-132253-11).

If you have any questions, or if we can be of any assistance in your consideration of the issues summarized above, please do not hesitate to contact the undersigned at the NTRA offices: 859-422-2602 or awaldrop@ntra.com.

Finally, we respectfully request the opportunity to appear before any hearing held by Treasury or the Service related to the proposed regulation project (REG-132253-11) to speak in support of these proposed changes to Section 31.3402(q)-1.

Sincerely,

Alexander M. Waldrop
President and CEO