

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

Dear Secretary Lew:

Thoroughbred horse racing has been a part of the American economy for more than 300 years. Today, nearly 40 states are home to horse racing tracks and every state has racehorse breeding farms. This industry is important in our states and to the districts we represent. We write to request that the Treasury Department 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.

The industry generates \$10 billion for the U.S. economy and is responsible for tens of thousands of jobs. In addition, wagering produces hundreds of millions of dollars in taxes for states and localities in which racing tracks are located, so it is essential that Federal tax obligations are understood and properly carried out. We are concerned that existing guidance in this area may need some revision in order to correctly apply in today’s wagering environment.

As with other sectors of the economy there have been innovations in pari-mutuel wagering, specifically the growth in combination or exotic wagers that offer the prospect of large payoffs. When the current regulations were first put in place in the 1970s, few wagers would have been impacted as wagering offerings were few. Nonetheless, the underlying premise behind pari-mutuel betting remains the same, that is, bets of a particular type are placed together in a “pool.” Individual winnings are determined as a proportion of the winning bets in that pool to the total number of bets made into that pool.

Internal Revenue Code Section 3402(q)(3)(c) requires withholding if wagering proceeds are 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 wagered.”

In order to compute the “amount wagered,” Treasury regulations¹ appropriately contemplate that, with respect to pari-mutuel wagering, bets placed in the same “pool” should be treated as identical bets whereas bets placed in different pools should be treated separately. On this point, the regulation states:

For example, amounts paid on two bets placed in a pari-mutuel 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 pari-mutuel 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.

Therefore, for reporting and withholding purposes, winnings from that pool should be calculated as total proceeds minus total wagers with respect to that pool. Unfortunately, the instructions to the

¹ See Treas. Reg. § 31.3402(q)-1(c)(1)(ii)

Form W2-G, when explaining how to treat multiple wagers in the same pari-mutuel pool, appear to conflict with the regulations.

The instructions instead reflect a 1978 letter ruling in which the Service² held:

We concluded, therefore, that your multiple wager \$6 box bet ticket must be considered to be six individual \$1 bets and not one \$6 bet for purposes of computing the amount to be reported or withheld. Winnings on a \$6 box bet must be reported if they are \$600 or more and if the winning combination pays off at 300 times the \$1 bet; and Federal income tax must be withheld if the winnings amount to more than \$1000 after the price of the wager (\$1) has been subtracted.

This ruling appears to ignore the fact that even though the \$6 box ticket represented the placing of a \$1 bet on each of six different combinations, all of those wagered amounts were part of a single pari-mutuel pool.

Approximately 30 million Americans wager on pari-mutuel horse racing each year. In addition, nearly 70 percent of the total amount wagered on thoroughbred racing is represented by wagers on Exactas, Trifectas, Superfectas, Pick 3, Pick 6 and other so-called exotic wagers. Due to the growing popularity of these types of wagers, virtually any horse player may find himself or herself standing in the "IRS line" at a racetrack. Every one of horse racing's more than 1,200 wagering service sites must calculate, track, withhold and forward to the IRS any federal tax due on winnings over \$5,000.

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 the 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. The ultimate adverse impact is a downward economic spiral for the industry with reduced purses, less wagering, less tax and economic benefit to localities and states and job losses at tracks, farms, breeding operations and related entities.

Thus, it is important, not just to avoid unnecessary paperwork, but also to avoid imposing an erroneous tax liability on a taxpayer, and to avoid inappropriately reducing the revenues otherwise due to states and localities, that the Federal tax regulations be understood and applied consistently to today's wagering environment. . We believe that the current regulations should be updated to reflect innovations and changes in today's wagering by changing the definition of a bet or wager to include the total amount wagered into each specific pool in determining the total cost of each wager for the purposes of calculating the reporting and withholding thresholds.

We appreciate your timely attention to this matter and look forward to your response.

Sincerely,

Charles Boustany Jr., MD

John Yarmuth

² See PLR 7823066.