

## The OTB Cash Cow

In describing the current status of New York City OTB [NYCOTB], New York City Mayor Michael Bloomberg has recently stated, “The state uses it as a cash cow, and the city has been subsidizing the state, and we are not going to continue to do that,”<sup>1</sup>

According to the New York Sun, “For the past four years the city has been lobbying the state to revamp the revenue-sharing system in a way that would more evenly divvy up the money OTB throws off. So far, lawmakers in Albany have not acted.”<sup>2</sup>

The New York Post has editorialized, “For the past four years, the agency has found itself on the short end of an onerous revenue-sharing arrangement with Albany that all but ensures that it won't make a profit.”<sup>3</sup>

The Post stated, “Last year, OTB posted a gross profit of \$125 million - but had to pay the state \$134 million. The result: a \$9 million hole”<sup>4</sup>

The City Comptroller Bill Thompson also chimed in stating, “We are being ripped off by the state. It's as simple as that.”<sup>5</sup>

Mayor Bloomberg suggested that were it not for the 1500 employees of New York City OTB, he would contemplate closing down OTB. Mayoral aides claimed, however, that only the state legislature could close down NYCOTB.<sup>6</sup>

But what about reality? Are Mayor Bloomberg's and Comptroller Thompson's assessments accurate? Is the City being ripped off? Is the State using NYCOTB as a cash cow?

### What is the Law?

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<sup>1</sup> Diane Cardwell, “Citing a Drain on Profits, Bloomberg Wants to Close OTB,” New York Times, October 19, 2007. See also Sara Kugler, “All Bets May Be Off for New York OTB,” AP, October 18, 2007.

<sup>2</sup> Jill Gardiner, “Revenue-Sharing Split Could Close City OTB Parlors,” New York Sun, October 19, 2007.

<sup>3</sup> “OTB: Off Track Again,” New York Post, October 22, 2007.

<sup>4</sup> Id.

<sup>5</sup> Avid Seifman and Sam Goldsmith, “Mike Warns: I'll Put OTB Out To Pasture,” New York Post, October 19, 2007.

<sup>6</sup> Id.

In 2003, the New York State budget imposed a regulatory fee of .39% on all wagers placed in New York State.<sup>7</sup> This placed the cost of regulating the racing industry on the racing industry instead of the charge being placed directly on the State. Thus, the costs for running the Racing and Wagering Board were placed on the industry itself rather than on the State's taxpayers through an allocation from New York State. The idea was to treat the Racing and Wagering Board in a manner similar to other regulatory agencies whose regulatory costs are funded directly by the regulated industry – such as the Public Service Commission and the Insurance Department.

The quid pro quo for this regulatory fee to the racing industry was that there would now be unlimited simulcasting of out-of-state thoroughbred racing. Previously, evening thoroughbred racing<sup>8</sup> from non-New York State tracks had largely been banned as part of the perceived need to protect New York's harness tracks.<sup>9</sup> New York City lobbied for the change in the law to authorize evening thoroughbred racing.<sup>10</sup> New York City had estimated that evening thoroughbred racing would earn \$15 million for the City<sup>11</sup> by increasing handle by \$150 million.<sup>12</sup>

The amount assessed in 2003 proved inadequate to pay for the costs of the Racing and Wagering Board. Thus, in 2005 the State budget increased the regulatory fee from .39% to .50%.<sup>13</sup> The regulatory fee remains at .5%

### The Amounts

While Mayor Bloomberg may have believed that the State was paid \$134 million, the figures from the State Racing and Wagering Board show that the State was paid \$12.237 million by New York City OTB.<sup>14</sup> This amounted to \$5.3 million from the regulatory fee plus \$6.9 million in traditional pari-mutuel taxes.<sup>15</sup> The traditional pari-mutuel tax rate stands at approximately .65%. In toto, this represents a tax rate – imposed much like a gross receipts tax – of 1.15%.

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<sup>7</sup> L. 2003, Ch. 62, Part F3

<sup>8</sup> Defined as being from 7:30 PM to midnight

<sup>9</sup> See Racing Law Section 1017-a added by L. 2003, Ch. 62.

<sup>10</sup> David Seifman, "Bloomberg To Albany: Help!," New York Post, November 15, 2002.

<sup>11</sup> David Saltonstall, "Gov's OTB Plan Gets City Neigh," Daily News, February 20, 2003.

<sup>12</sup> Joe Mahoney, "Nighttime Racing On Fast Track," Daily News, January 17, 2003.

<sup>13</sup> L. 2005, Ch. 59 Part B.

<sup>14</sup> All revenue and tax numbers are from the annual reports of the New York State Racing and Wagering Board. The most recent reports of the Racing and Wagering Board can be found at <http://www.racing.state.ny.us/about/annual.htm>.

<sup>15</sup> The traditional pari-mutuel taxes consist of the regular pari-mutuel tax on handle plus the State share of the breakage on handle.

Historically, a 1.15% tax on NYCOTB handle is not an overwhelmingly high amount. In the early days of NYCOTB, the pari-mutuel tax rate on NYCOTB (well before the existence of a regulatory fee) was far higher than 1.15%. For example in 1976, the rate was 1.82%, and the State earned \$14.3 million on NYCOTB handle of \$786 million. In the early 1980's, the tax rate on NYCOTB wagers was approximately 1.75%.

The tax rate on NYCOTB has decreased over the years. It stood at 1.53% in 1986 and 1.1% in 1996. By 2002, (the year before the imposition of the regulatory fee) the tax had fallen to .86%.

The New York Racing Association pays a far higher tax to the State than NYCOTB does. The tax rate at NYRA – which includes the regulatory fee – was 2.06% in 2006. Given the peculiar workings of the State' racing laws, the other OTB corporations in the State pay slightly higher taxes than NYRA. The combined pari-mutuel tax rate for the five OTB corporations outside New York – including the regulatory fee - City was 1.23%.

#### What Went Wrong?

The main thing that went wrong was that the City's estimates of added revenue from evening thoroughbred racing were wrong. The City estimated approximately a 15% handle jump with nighttime thoroughbred racing. Instead from 2002 -2006, handle increased only 2.9% at NYCOT from \$1.03 billion to \$1.06 billion. The prediction of \$15 million in extra revenue did not come true. So the City made a bad deal. It traded the regulatory fee for evening thoroughbred racing, and evening thoroughbred racing did not prove to be a winner.

Even assuming a bad deal, that bad deal by itself would not serve to explain NYCOTB's deficit of \$9 million.

If each added \$10 million in handle was supposed to net out to \$1 million in revenue for the City,<sup>16</sup> then the City's added \$30 million in handle should balance out the nearly .3% increase in the State pari-mutuel tax since 2002. The \$3 million in additional revenue from NYCOTB should have been matched by the \$3 million in added taxes. Even if the 2003 deal didn't make money for NYCOTB, the increase in taxes should have been matched by the increase in revenue from added handle.

Finally, the deficit for NYCOTB is stated to be \$9 million. The increase in the pari-mutuel tax rate from 2002 to 2006 is approximately .3%. That translates into \$3 million. If the problem truly was the State's added tax burden, that might explain \$3

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<sup>16</sup> See note 12 supra.

million of the \$9 million deficit. It would not explain \$6 million of that \$9 million deficit.

### The State's Cash Cow

The notion that the State has used NYCOTB as a cash cow is difficult to justify. The overall tax on NYCOTB was much higher for most of NYCOTB's existence. The tax basically stands at the same level as it was in 1996.

The State earned \$14.3 million in 1976 from NYCOTB when handle at NYCOTB was 3/4<sup>th</sup>'s of what it is today. In inflation adjusted terms, \$14.3 million in 1976 would translate into \$35 million in 2006. In inflation adjusted terms, New York State revenue from NYCOTB have fallen by 65% over 30 years.

Moreover, the other OTB's pay a higher tax to New York State. Why aren't they all running significant deficits? NYRA pays almost a full percentage point higher in pari-mutuel taxes to New York State. It is nearly impossible to find that the City has been ripped off or that the State has been using NYCOTB as a cash cow.

### The Real Problem

NYCOTB's real problems ought to be clear. Again, revenues are stagnant. Handle increased by 2.9% from 2002 -2006, but the increase in the inflation rate was 11.4%. As one of NYCOTB's own reports has stated, the racing industry is in crisis.<sup>17</sup> Few organizations are seen as having a less hospitable social environment than NYCOTB. Its operating expenses have increased sharply s most significantly because NYCOTB "has entered a \$110 million liability on its books to account for the cost of future health benefits for its 1,500 employees."<sup>18</sup>

NYCOTB has top-flight talent in its executive suite, but it's in a stagnant industry with a ton of fixed costs. It has an enormous pension problem. It does nobody any good to blame the problem on a supposed State rip off.

### Closing Down OTB

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<sup>17</sup> See <http://www.nycedc.com/NR/rdonlyres/E2C93C70-B0B4-4120-85E3-C4D10B8816E7/0/NYCOTBStratPlan.pdf>

<sup>18</sup> David Seifman, "Public Service Pays top Council Earner, New York Post, October 21, 2007.

After blaming the State for the problems of OTB, some in the Bloomberg administration apparently also want the State to take responsibility for any potential shutdown of OTB. That's not the way the world or the law works. If the City wants to shut down operations at NYCOTB, it is certainly free to do so. Nothing requires NYCOTB to take bets or operate branches. It has free will to continue or discontinue.

There is a problem in the totality of what NYCOTB should actually do. It is run by the City which certainly does not want to be responsible for the taking away 1,500 jobs. But, if it wants to run at a profit, it certainly could do so. You move out of the marginal branch offices – and just operate the profit centers. Anyone who has ever been at the most popular branch offices knows where they are. (The Chatham Square branch in Manhattan has always been an amazing experience.) You should be able to net revenues from phone and Internet wagering.

Of course, the problem here is the overall effect of a smaller NYCOTB on the State's racing industry. Since the racing industry gets its revenue based on the volume of business done by NYCOTB, a smaller – but profitable NYCOTB - translates into an OTB system with reduced handle. You have a gross receipts allocation with diminished receipts. Reduced handle means reduced revenues for racing. While that may no longer be the end of the world for racetracks with VLT's, as far as horsemen, breeders, and non-VLT racetracks are concerned, a smaller NYCOTB is simply bad news.

That would similarly be bad news for State revenues from NYCOTB, but since the State is hardly using NYCOTB as a cash cow, a smaller NYCOTB is probably the least of the State's concerns.