

For discussion
on 13 May 2005

Legislative Council Panel on Home Affairs

Proposed Reforms to the Betting Duty System on Horse Race Betting

Introduction

This paper seeks Members' views on a package of proposed reforms to the betting duty system on horse race betting conducted by the Hong Kong Jockey Club (HKJC).

Background

2. Under the existing Betting Duty Ordinance ("the Ordinance"), the HKJC is the only authorized operator to conduct betting on horse races in Hong Kong. At present, horse race betting is operated on a pari-mutuel basis, with the dividends of each pool calculated after deducting the betting duty for the Government and commission for HKJC from the total betting turnover. These deductions from the betting proceeds are also referred to as the "take-out" or "gross margins".

3. The existing take-out rate for "standard" bets (as defined in the Ordinance) is 17.5%, comprising the betting duty at 12% and commission for HKJC at 5.5% on betting turnover. The take-out rate for "exotic bets" (defined as any other bet types in the Ordinance) is 25%, comprising betting duty at 20% and commission for HKJC at 5% of betting turnover. The overseas bets (bets accepted outside Hong Kong and authorized by HKJC) are subject to betting duty at half the rate of bets received in Hong Kong. This duty concession was introduced in 1995 primarily as an incentive for the overseas host governments to co-operate with HKJC on the betting arrangements.

4. The turnover on horse race betting conducted by HKJC has declined steadily and significantly in recent years--from \$92.4 billion in 1996-97 to \$65 billion in 2003-04, representing a decline of around 30%. The Government's revenue from betting duty on horse race betting has

correspondingly dropped from \$12.3 billion to \$8.78 billion. According to HKJC's forecast, if no action is taken to tackle the decline, the betting turnover would decline by a further 30% by 2007-08.

5. HKJC has been finding ways to combat illegal bookmakers to capture the betting market, so that the decline of betting turnover may be arrested and the HKJC's current level of support for charities could be maintained. It commissioned an independent economic research consultancy study on how to tackle the structural problems leading to the decline of betting turnover. Taking into account the results of this study, HKJC submitted to the Government in late 2004 a package of proposals to reform the betting duty system on horse race betting. The Government has since been discussing with HKJC on the proposals.

The Need for Reforms

6. According to HKJC, while the decline in betting turnover has in part been a reflection of the prolonged economic downturn in recent years, it is largely due to certain structural reasons which have led to a shrinking share of authorized horse race betting in the overall gambling market.

Challenge from local illegal bookmakers and offshore bookmakers

7. HKJC's assessment is that the major structural problem is the growing illegal gambling market based on Hong Kong's horse races. This market is aided by low operating cost and improved communications technology. As the illegal bookmakers are not required to run the horse races and pay betting duty to the Government, they have an inherent advantage over HKJC by offering more attractive odds to bettors, discounts on losing bets, short-term credit and other incentives. Illegal bookmakers are making their presence known through a series of marketing channels, including operating a network of service providers offering personalized services to patrons at different entertainment venues, publishing their odds in newspapers, publishing "racing tips" newspapers and booklets, putting up websites (some imitating HKJC's own website) and direct mailing.

8. According to a survey commissioned by HKJC in January 2005,

around 13% of horse racing bettors who bet on Hong Kong races have also placed bets with illegal or offshore bookmakers. The availability of credit betting is one of the major reasons why bettors are placing bets with illegal bookmakers, and over 60% of them received a discount of 8 – 10% on bets. The illegal local bookmakers are particularly attractive to those placing relatively greater bets.

9. Enforcement statistics from the Police indicate that illegal bookmaking activities on horse race betting in Hong Kong have been a long-standing problem. Recent enforcement statistics and experience indicate that an increasing number of illegal bookmakers have adopted new modes of operation, including taking bets through websites on the Internet and making use of intermediaries to recruit punters. They are usually offering a variety of gambling activities round the clock, for example horse racing betting, football betting and fixed-odds games on HKJC's Mark Six numbers. The total amount of cash and betting slips seized from illegal bookmakers of horse racing and those offering both horse racing and football betting has risen from \$9.38 million in 2001 to \$19.7 million in 2004.

10. HKJC claims that they are also facing stiff competition from off-shore bookmakers who conduct betting on both Hong Kong and overseas horse races on the Internet, alongside other forms of betting activities. Although most off-shore bookmakers have moved their bases of operation away from Hong Kong after the enactment of the Gambling (Amendment) Ordinance 2002 which prohibited cross-border gambling and related promotional activities, many off-shore bookmakers continued to provide betting on a wide range of activities on the Internet. They target residents in Asia particularly China, including Hong Kong. The off-shore bookmakers are often able to offer more attractive odds than HKJC due to the lower duty rates in the jurisdictions where they are based. They also provide a wider range of betting products covering horse racing, sports betting and lottery games to meet the demand of bettors. Apart from off-shore bookmakers, the emergence of "betting exchanges" on the Internet also poses a threat to authorized horse race betting. Betting exchange is a kind of on-line platform for bettors to bet among themselves on the results of certain events such as football matches, horse races and other sports activities.

Inadequacies of the existing betting duty system and regulatory regime on horse race betting

11. In the face of the dynamic illegal gambling market as described above, the existing betting duty system and regulatory regime on horse race betting which had been in place since the 1970s has become inadequate for the purpose of effectively combating illegal gambling. Specifically, the betting duty system whereby betting duty is charged on the basis of turnover on standard and exotic bets provides very little flexibility for HKJC to adjust the take-out rates for different bet types, or adjust the odds in response to the changing market conditions so as to divert bettors into the authorized channels.

12. HKJC is also of the view that the relatively high rates of betting duty on turnover (12% and 20%) in Hong Kong as compared with other major racing jurisdictions (on average below 10%) has made illegal operators increasingly attractive. Moreover, HKJC considers that this has made it uncompetitive in exporting its racing products to overseas racing jurisdictions by way of overseas betting arrangements (currently subject to half of the betting duty rates on local betting turnover).

Proposed reforms to the betting duty system

13. Taking into account the need for changes, we propose a package of reforms to the betting duty system. They seek primarily to enhance the effectiveness of authorized horse race betting in combating illegal gambling while maintaining the betting duty revenue at a steady level. The major components are set out in the following sub-paragraphs -

a) *Conversion of betting duty on horse race bets from turnover-based to a tax on net stake receipts (gross margins)*

We propose to convert the betting duty from the current turnover-based duty system for horse race betting to a new system based on the net stake receipts (or gross margin, i.e. betting turnover minus payout). This would be similar to the betting duty system for authorized football betting. Under the new duty system, a single set of duty rates will be applied to the net stake

receipts irrespective of bet types. A progressive duty system will be adopted, with duty to be charged at 72.5% of the net stake receipts up to \$11 billion, increasing by half a percentage point for increases of every \$1 billion in the receipts up to \$15 billion, and at 75% for the receipts exceeding \$15 billion. The schedule of progressive duty rates is illustrated below:

<i>Annual gross margin</i>	<i>Duty rate (%)</i>
Up to \$11 billion	72.5
\$11 – 12 billion	73
\$12 – 13 billion	73.5
\$13 – 14 billion	74
\$14 – 15 billion	74.5
Over \$15 billion	75

The above rates largely reflect the Government's share of the racing receipts vis-à-vis the HKJC under the current system. The progressive duty system would ensure that General Revenue would benefit more at higher gross margin levels.

To tie in with this change in the charging system, the distinction in tax rate between standard bets and exotic bets would be removed.

b) Betting Duty on Overseas Bets

For overseas bets, betting duty is currently charged at half of the prevailing duty rate on the relevant bet type, i.e. at 6% for standard bets and 10% for exotic bets. This duty concession was introduced in 1995 primarily as an incentive for the overseas host governments to co-operate with HKJC on the betting arrangements. Under the new system, the duty rate would not be less than 50% of the basic duty rate (i.e. 72.5%) of the annual gross margin. The duty rate may be raised in the case of individual jurisdictions to cater for the situation whereby the overseas host government does not require as high as half of the betting duty reduction as an incentive for effecting the arrangement.

c) Guarantee of betting duty revenue

To ensure that the Government's revenue from horse race betting

would remain stable during the first few years, HKJC would guarantee that the duty receivable during each of the four years from implementation would be no less than \$8 billion plus the amount of duty in respect of any overseas bets. The \$8 billion guaranteed minimum is higher than the HKJC's projected duty for the year 2005-06 assuming there is no duty reform. A review would be conducted three years after implementation of the new duty system to see if it produces desirable results and whether it should be continued.

d) Extension of racing season

At present, there is a summer recess for HKJC's horse racing season in July and August every year. Since punters are currently able to place bets on horse races all over the world at different times of a year owing to advances of communications technology and wider use of the Internet, we propose to allow the HKJC to slightly extend its annual racing season by five days, and modestly increase the frequency of simulcasting major international races approved by established international racing authorities each year.

Proposed measures to rationalize the regulatory regime

14. We propose to take this opportunity to rationalize the regulatory regime of horse racing betting in order to bring it broadly in line with the authorized football betting and lotteries under the Ordinance. The specific proposals are set out as follows:

- a) To remove the authority of the Chief Secretary for Administration to issue a written permit to HKJC or other clubs to conduct betting on horse and pony races and impose conditions as he sees fit; and confer the same authority on the Secretary for Home Affairs (SHA). Under the Accountability System for Principal Officials (POs), each PO should be held responsible for exercising authority under his own policy portfolio. SHA, as the Policy Secretary responsible for the formulation of gambling policy, should be vested with the authority to issue a written permit and impose conditions for conducting betting on horse races.

- b) Similar to football betting, the licensee for horse race betting should be authorized to conduct fixed odds or pari-mutuel betting on the results of, or contingencies relating to, horse races.
- c) The functions of the existing Football Betting and Lotteries Commission should be expanded to include advising SHA on the regulation of the conduct of betting on horse racing; as well as compliance of licensing conditions by the licensee. The title of the Commission would also be revised to reflect this change.
- d) The operational and regulatory regime of betting on horse races should basically follow that of football betting and lotteries. Specifically, we propose that the licensing conditions for authorized horse race betting activities would prohibit credit and underage betting; restrict promotional activities and materials; display messages to warn against excessive gambling; and provide information on how to seek help on problem gambling. We also propose that the existing Appeal Board under the Betting Duty Ordinance be tasked to decide appeals lodged by the HKJC (and any other clubs given a written permission to conduct betting on horse races) in addition to those lodged by the licensees of football betting and lotteries.

Assessment of the impact of reform

15. We consider that the above proposed reforms to the betting duty system together with the proposed changes to the regulatory regime on horse race betting should enhance the competitiveness of authorized horse race betting vis-à-vis the illegal and offshore bookmakers and enable the HKJC to capture a larger share of the gambling market by diverting more effectively the bet placed with illegal and offshore bookmakers to the authorized channel, while protecting the Government's betting duty revenue.

16. We also consider that it is not likely that the proposed reforms to the betting duty system on horse race betting would give rise to a substantial increase in public participation in horse racing, as the

proposed betting duty rates on net stake receipts reflect largely the Government's share of betting receipts under the current system. The increased flexibility in setting the take-out rates for different bet types would mainly serve to divert bets with illegal gambling market to the authorized channel. The extended racing season seeks mainly to stem the current leakage of betting turnover to illegal or offshore bookmakers during the summer break.

17. The proposed measures to rationalize the regulatory regime for the conduct of betting on horse races would help to minimize the negative impact of horse race betting on the community, in line with the effects of similar licensing conditions on authorized football betting and lotteries.

Way forward

18. Subject to members' views on the above package of proposals to reform the betting duty system for horse race betting, the Administration intends to introduce a Bill to amend the Betting Duty Ordinance to give effect to the proposals later this year.

Home Affairs Bureau
May 2005