

**For discussion on
18 February 2013**

Legislative Council Panel on Home Affairs

Two-way Commingling

Purpose

This paper briefs Members on the legislative proposals on the Betting Duty Ordinance (Cap. 108) (“BDO”), which involve technical amendments that will facilitate the conduct of two-way commingling on horse race betting.

Background

2. In accordance with section 6GB of the BDO, the Secretary for Home Affairs (“SHA”) may, by issuing a licence, authorize the company to conduct betting on horse races. Under the prevailing Licence for Horse Race Betting, the Hong Kong Jockey Club (“HKJC”) Horse Race Betting Limited as the only licenced horse race betting conductor in Hong Kong may conduct betting on both local and non-local horse races.

3. According to prevailing norm and practice in the racing industry, a local betting pool may be managed by a horse race conductor as a “separate pool”. If the local and non-local betting pools concerned are amalgamated, the two betting pools are managed as a “commingled pool”. Under such a commingling arrangement, the participating jurisdictions follow the same dividend distribution rates for the bet type(s) concerned. This would reduce the possibility of illegal bookmakers taking advantage of arbitrage of odds differences as a result of the existence of multiple separate pools in various jurisdictions in respect of the same bet type on the same race, thus discouraging off-shore and illegal bookmaking activities. The size of bets in a commingled pool is typically larger than that in a separate pool, thus offering more stable odds to bettors.

Inbound commingling

4. Local horse races are conducted by the HKJC on a maximum of 83 days within a racing season. The HKJC accepts bets placed by bettors in Hong Kong on such local races and manages these bets under a “separate betting pool”. Under the existing BDO, betting duty is levied on such local bets based on the progressive betting duty rate¹. Nevertheless, for some local races which have been broadcast outside Hong Kong, the HKJC may also amalgamate the non-local bets in respect of the same bet type on the same local race(s) with these local bets to form a commingled pool under its management. Under this arrangement which is referred to as the inbound commingling arrangement, both the local bets and the non-local bets are subject to betting duty charged at the above progressive betting duty rates but a discount rate² is stipulated in the BDO.

5. According to the prevailing international norm and practice, betting duty would only be levied at source (i.e. by the jurisdiction where the bet is made). In other words, betting duty would not be charged on the non-local bets amalgamated into a commingled pool. In this regard, the levying of betting duty on non-local bets (which are not sourced from Hong Kong) amalgamated into the commingled pool managed by the HKJC as described in paragraph 4 above is not in line with the international norm and results in such non-local bets being doubly taxed by both the non-local jurisdiction (i.e. tax at source) and Hong Kong. This has made inbound commingling arrangement unattractive to non-local partners of the HKJC³ and hence they opt for separate non-local pool arrangements domestically in respect of Hong Kong races. For such separate pool arrangements, the Government charges profits tax under the Inland Revenue Ordinance (Cap. 112) (“IRO”) on the HKJC’s royalty income for ‘exporting’ local horse races to other jurisdictions.

Proposal

6. To address the situation, the HKJC proposes the following improvements to the current taxation regime on inbound commingling

¹ Under the current betting duty system for horse race betting, a progressive rate of 72.5% to 75% specified in Schedule 1 to the BDO is applied to the net stake receipts of both local and non-local bets so long as the bet pools concerned are managed by the HKJC, but a discount rate as specified in Schedule 2 to the BDO may be further applied on the non-local bets.

² The betting duty rates applicable to non-local bets managed by the HKJC are results of applying a 50% discount rate (or 40% for Macau bets) as specified in Schedule 2 to the BDO to the progressive betting duty rates as specified in Schedule 1 to the BDO. The arrangement with Macau has now ceased.

³ The only jurisdiction which maintained an inbound commingling arrangement with the HKJC has terminated the arrangement from the 2012/13 racing season onwards.

arrangement by –

- (a) adjusting the betting duty regime of Hong Kong in order to align with the prevailing international norm and practice, that is, to levy betting duty only at source. In other words, Hong Kong should not levy betting duty on non-local bets which are amalgamated into the commingled pool managed by the HKJC. It follows that the relevant betting duty provisions in the BDO should be removed; and
- (b) allowing the HKJC to enter into commercial discussion with its non-local partners to determine the split of gross margin between the HKJC and its partners in other jurisdictions. Profits tax would then be charged by the Government in accordance with the IRO on the HKJC's share of gross margin after deducting operating cost and deductible expenditure.

The Government's Considerations

7. The Government considers that the above proposed taxation adjustments are essential to facilitate more inbound commingling activities. Besides the merits as described in paragraph 3 above, more inbound commingling activities would mean more "exports" of Hong Kong's world class races. This would enable the HKJC to raise its international and regional profile. Introducing these prestigious races of Hong Kong to other jurisdictions could also enhance the exposure of local jockeys and horses, which could in turn enhance their competitiveness on the international front. From the perspective of regulating gambling opportunities, no additional gambling opportunities will be introduced to Hong Kong as a result of the proposed taxation adjustments. Therefore, the proposal is in line with the long-standing gambling policy that gambling activities should be restricted to a limited number of authorized gambling channels and the objective of authorizing gambling outlets to combat illegal gambling activities.

8. From the Government's fiscal perspective, HKJC's proposed taxation structure on inbound commingling arrangement as stated in paragraph 6 above should not result in any material loss of government revenue, given the fact that all non-local bets placed on Hong Kong races are now placed in separate pools managed by non-local partners of the HKJC whereby profits tax is charged on the royalty income earned by the HKJC under such arrangements. In other words, the Government currently receives no betting duty from the inbound commingling arrangement.

Hence, the proposed elimination of the betting duty for non-local bets under an inbound commingling arrangement as stated in paragraph 6(a) above would not have any material impact on government revenue. According to the HKJC's proposal, some of the HKJC's existing royalty income earned from the non-local bets (which are currently placed in separate pools managed by the HKJC's non-local partners) would be replaced by the share of gross margin under the inbound commingling arrangement in future for which the charging of profits tax would equally apply. On the other hand, the HKJC envisages that their proposal would enhance its competitiveness to attract non-local partners in entering into inbound commingling arrangement with them, thus generating more taxable profits for Hong Kong. That said, the current exercise is not driven by revenue considerations.

9. Given the above considerations, the Government has no difficulty with the HKJC's proposed inbound commingling arrangement as set out in paragraph 6 above.

Legislative amendment

10. The calculation basis for horse race betting duty levied on non-local bets placed on local races as well as the mathematical formula for the calculations provided in the BDO will require amendments.

Outbound commingling

11. The HKJC has been accepting bets of Hong Kong bettors on some prestigious non-local races⁴ and managing such local bets in separate pools, under an arrangement known as the simulcast arrangement. The Government receives betting duty on these separate pools of local bets in the same manner as local bets placed on local races in accordance with the BDO.

12. If these local bets from Hong Kong bettors placed on non-local races are amalgamated into a commingled pool with other non-local bets accepted by a non-local horse race betting conductor (which is a non-local partner of the HKJC) in respect of the same bet type of the same non-local race, the arrangement is called the outbound commingling arrangement. However, the BDO does not provide for a separate and specific taxation structure for the purpose of levying betting duty on local bets that are handled in an outbound commingled pool. Local bets accepted by the

⁴ The quota for such simulcast races on which the HKJC may accept bets is capped at 10 falling on local race days and that for simulcast days is capped at 15 on non-local race days for each racing season.

HKJC under an outbound commingling arrangement are now subject to the progressive betting duty rates stipulated in Schedule 1 to the BDO.

13. The non-local partners of HKJC would expect Hong Kong to offer outbound commingling while conducting inbound commingling as a total package (i.e. allowing both outbound and inbound commingling). This type of reciprocal arrangement is a common “free trade” practice worldwide. However, in the absence of a specific taxation structure for the outbound commingling arrangement, the current taxation structure which levies progressive betting duty rates would create uncertainty to its non-local partners. In reality, no outbound commingling arrangement has ever been carried out by the HKJC. This is one of the reasons leading to the diminution of inbound commingling activities.

Proposal

14. In order to provide a larger degree of certainty for HKJC’s negotiations with its non-local partners, the HKJC proposes that instead of applying the current progressive betting duty rates from 72.5% to 75% on the net stake receipts of local bets on non-local races (whether the local bets are managed in a separate pool or an outbound commingled pool), the Government should charge a flat betting duty rate at 72.5% and a certain percentage of the fees to be paid by the HKJC to its non-local partners should be deducted for the betting duty calculation⁵.

The Government’s Considerations

15. From the perspective of a horse race betting regulator, the Government accepts the HKJC’s argument that to align with international practice of reciprocity and fair trade, two-way commingling of horse racing should be pursued. For reasons explained in paragraph 3 above, the Government supports outbound commingling arrangements from the perspective of combating illegal gambling. There may be concerns that a larger and more stable bet pool as a result of an outbound commingling arrangement would mean increased attractiveness of a non-local race to Hong Kong bettors, and outbound commingling might entice those Hong Kong bettors who currently are not interested in non-local races to also bet

⁵ The product fees paid by the HKJC to its non-local partners under the current simulcasting arrangement are 1.5% of the local turnovers (except for Macau which is 1%). The HKJC has proposed that for accepting local bets on non-local races under the new two-way commingling arrangement, if the amount of fees to be paid by the HKJC to its non-local partners is higher than the current level (i.e. 1.5% of the local turnovers), the excess amount should be deducted in calculating the amount of betting duty charged under the proposed arrangement.

on such races. According to the industry's understanding, only a small group of enthusiastic racing fans and major bettors are interested in non-local races, as betting on such races requires good knowledge of the races and the competing jockeys and horses. In addition, there is a language barrier for the majority of the grass-root local bettors. The time difference between Hong Kong and some of the host countries constitutes an added deterrent factor. Nonetheless, to ensure that the implementation of the outbound commingling arrangement does not lead to an increase in betting opportunities, we will restrict it to the existing scale of non-local simulcast races (i.e. 10 races on local race days and 15 simulcast days on non-local race days in each racing season). The HKJC will be provided with flexibility to convert local bets on non-local simulcast races from separate pools into outbound commingled pools where necessary in order to satisfy the non-local partners' expectation of reciprocity.

16. From the fiscal perspective, according to the projection of the HKJC based on the figures for the 2010/11 racing season, there will be a decrease of \$12 million in betting duty receipts under the proposed betting duty arrangement for Hong Kong bets on non-local races (mainly due to reduction in tax base after reflecting certain portion of the increased product fees and the proposed flat duty rate mentioned in paragraph 14 above).

Guarantee

17. While we consider the HKJC's proposals justifiable on policy grounds, we are mindful of any potential loss in government revenue under the proposed outbound commingling arrangement as stated in paragraph 16 above. In this regard, we see the need to seek a guarantee from the HKJC on the betting duty receipts arising from Hong Kong bets on non-local races. As the Government has no intention to regard betting duty as a tool to increase government revenue, the objective of the guarantee is to ensure no revenue loss in the initial period of the new commingling arrangements, instead of maximizing government revenue from the racing business in the long run. With reference to the duration of guarantee provided by the HKJC in the last betting duty reform in 2006, the Government and the HKJC have agreed in principle that a guarantee lasting for three years should be reasonable for the purpose of protecting government revenue during the transitional period.

18. In determining the quantum for the proposed guarantee, we consider it reasonable to pitch the guaranteed amount at the existing level of

betting duty receipts arising from the current simulcast arrangements. In this regard, we propose a fixed sum of \$175 million a year, which is the average of the preceding three years' betting duty receipts (i.e. from 2009/10 to 2011/12 racing seasons) arising from Hong Kong bets on non-local races simulcast by the HKJC. In effect, during the three-year guarantee period, the annual amount receivable by the Government would be the actual amount of betting duty receipts arising from Hong Kong bets placed on non-local races as computed based on the relevant provisions under the BDO or the above-mentioned guaranteed amount of \$175 million, whichever is the higher. This should provide adequate safeguard to the Government's duty revenue in the initial years of the reform.

Legislative amendment

19. New provisions will be required for the BDO to enable the Government to tax local bets placed on non-local races, whether on all or selective bet types managed in separate or commingled pools, based on a flat rate at 72.5% as described in paragraph 14 above. New provisions will also be required for the BDO to specify the amount and duration of guarantee provided by the HKJC under the new commingling arrangement.

Timing

20. We plan to introduce the Betting Duty (Amendment) Bill into the Legislative Council ("LegCo") in the second quarter of 2013 such that the two-way commingling arrangement under a new taxation structure can become effective starting from the 2013/14 racing season.

Advice Sought

21. Members' views are invited on the proposals. Subject to Members' views, we will introduce the Betting Duty (Amendment) Bill to the LegCo in the second quarter of 2013.

**Home Affairs Bureau
February 2013**