

REPORT OF THE
OFFICE OF THE AUDITOR GENERAL

256

FINANCIAL OPERATIONS OF
CALIFORNIA HORSE RACING ASSOCIATION AND
PENINSULA HORSE RACING ASSOCIATION

APRIL 1975

TO THE
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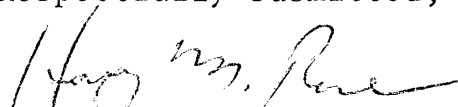
April 11, 1975

Honorable Bob Wilson
Chairman, and Members of the
Joint Legislative Audit Committee
Room 4126, State Capitol
Sacramento, California 95814

Dear Mr. Chairman and Members:

Transmitted herewith is our report on the financial operations of California Horse Racing Association and Peninsula Horse Racing Association and our evaluation of the financial impact on these associations if existing law is not changed.

Respectfully submitted,


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INTRODUCTION

In response to a legislative request, we have reviewed the financial operations of the California Horse Racing Association and the Peninsula Horse Racing Association. The California Capital Trotting Association, which was initially included in our review, is no longer in active operation. Racing dates for 1975 originally awarded to the California Capital Trotting Association have since been awarded to Golden Bear Raceway, Inc., a newly formed organization.

Under existing law (Sec. 19614, Bus. & Pro. C.), a state license fee advantage, 5.50 percent rather than 6.10 percent, is given to those racing associations that have a total parimutuel handle of \$20 million or less annually. This law also exempts such associations from the requirement to pay a statutory percentage of the total parimutuel handle in the form of purses paid to horse owners. Since 1971, both California Horse Racing Association and Peninsula Horse Racing Association have operated under Section 19614.

The purpose of our review was to evaluate the relative operating efficiency of California Horse Racing Association and Peninsula Horse Racing Association and to determine the financial impact on these associations if they are no longer permitted to pay the lower license fee provided for under Section 19614, as will be the case under existing law, beginning July 1, 1975.

Both California Horse Racing Association and Peninsula Horse Racing Association have stated that their race meetings might be cancelled if the license fee rate is increased on July 1, 1975.

During the course of our examination, we were allowed free access to the books and records of these associations and were also able to review the working papers of Ernst and Ernst, Certified Public Accountants, who annually perform independent audits of the two associations.

Our evaluation included a determination of the accuracy and propriety of reported income and expense items of each association for fiscal years 1971-72 through 1974-75. In addition, we compared the profitability of these two associations with other horse racing associations and analyzed the relative operating efficiency of each association. The net income (or loss) before taxes for each association was projected for fiscal years 1975-76 through 1980-81, based upon the various assumptions described in this report. The projections are based upon historical trends regarding attendance, average wagering per attendant and operating expenses.

BACKGROUND

Under existing state law, all money wagered at a horse racing meet licensed by the state is distributed as follows: (1) back to the betters in the form of winnings, (2) to the state as a license fee, (3) to the horse owners as purses, (4) to the racing association licensed by the state to conduct the meet as a commission and, in some instances, (5) to the horse breeders as breeders fees.

Currently, 84.25 percent^{1/} of all money wagered at a horse race meeting is paid back to winning ticket holders, while the remaining 15.75 percent is divided between the state, the horse owners, the racing association and, in some instances, the horse breeders.

Sections 19611, 19612, 19614 and 19616 of the Business and Professions Code mandate how the 15.75 percent is to be divided between the state, the horse owners and breeders, and the racing association, and are summarized in Tables 1, 2 and 3 on the following pages.

^{1/} In parimutuel betting on horse races, the winning ticket holders divide 84.25 percent of the money wagered; however, winning tickets are not paid in odd cents. For example, on a \$2.00 wager the winning ticket may be worth \$4.56, however, the payment will only be \$4.50 with the extra \$.06 (called "breakage") being either retained by the track, or paid as purses to the horse owners, or to the state. The distribution of the breakage is mandated by state law.

Table 1

Distribution of 15.75 Percent of Total Annual
Parimutuel Handle for Thoroughbred Racing Meets -
Per Section 19611 of the Business and Professions Code

<u>Total Annual Parimutuel Handle</u>	<u>Total Per- cent To Be Distributed</u>	<u>State License Fees</u>	<u>Racing Association Commissions</u>	<u>Purses To Horse Owners</u>	<u>Horse Breeder Awards^{2/}</u>
<u>Base Rates for First \$20 Million of Handle</u>					
\$ 0 - \$ 20 million	15.75%	6.10%	5.29%	4.16%	.2%
<u>Rates for Handles in Excess of \$20 Million</u>					
\$ 20 - \$ 40 million	15.75	5.70	5.52	4.33	.2
\$ 40 - \$ 75 million	15.75	6.55	5.04	3.96	.2
\$ 75 - \$120 million	15.75	6.85	4.87	3.83	.2
\$120 - \$180 million	15.75	7.15	4.70	3.70	.2
\$180 - and above	15.75	7.45	4.54	3.56	.2

^{2/} Section 19616 of the Business and Professions Code provides that the horse breeder awards of .2 percent would be applicable only to the thoroughbred racing associations. Other racing associations are required to pay any breeders' awards out of the amount deducted from the handle.

Table 2

Distribution of 15.75 Percent of Parimutuel Handle For
 Harness and Quarter Horse Racing Meets - Per Section
19612 of the Business and Professions Code

<u>Total Annual Parimutuel Handle</u>	<u>Total Per- cent To Be Distributed</u>	<u>State License Fees</u>	<u>Racing Association Commissions</u>	<u>Purses To Horse Owners</u>
<u>Base Rates for First \$20 Million of Handle</u>				
\$ 0 - \$ 20 million	15.75%	6.10%	5.74%	3.91%
<u>Rates for Handles in Excess of \$20 Million</u>				
\$ 20 - \$ 40 million	15.75	5.70	5.98	4.07
\$ 40 - \$ 75 million	15.75	6.55	5.48	3.72
\$ 75 - \$120 million	15.75	6.85	5.30	3.60
\$120 - \$180 million	15.75	7.15	5.12	3.48
\$180 - and above	15.75	7.45	4.94	3.36

Table 3

Distribution of 15.75 Percent of Total Annual Parimutuel
 Handle for Racing Associations Handling \$20 Million or Less -
Per Section 19614 of the Business and Professions Code

<u>Total Annual Parimutuel Handle</u>	<u>Total Per- cent To Be Distributed</u>	<u>State License Fees</u>	<u>Racing Association Commissions & Purses To Horse Owners</u>
\$0 - \$20 million ^{3/}	15.75%	5.50%	10.25%

^{3/} If the total annual parimutuel handle exceeds \$20 million, the distributions of the 15.75 percent shown in Tables 1 and 2 become applicable.

With regard to Tables 1 and 2 on pages 4 and 5, only two rates are applicable, a base rate on the first \$20 million and the rate appropriate for

the parimutuel handle in excess of \$20 million. For example, a harness racing meet with a total parimutuel handle of \$50 million would pay a state license fee of 6.10 percent on the first \$20 million of parimutuel handle and a state license fee of 6.55 percent on the remaining \$30 million.

With regard to Table 3, under Section 19614, only one state license fee rate is applicable, 5.50 percent of the parimutuel handle. The distribution of the remaining statutorily required 10.25 percent of the parimutuel handle between the horse owners as purses and the racing association as commissions is based upon a negotiated agreement between the racing association and the horse owners and is not established by law as it is for racing associations handling more than \$20 million, under Sections 19611 and 19612.

Section 19614 of the Business and Professions Code, which exempts racing associations handling \$20 million or less from distributing the 15.75 percent of parimutuel handle per Tables 1 or 2 above, also provides that "...No such association, or its successor in interest, except the California State Fair and Exposition or a district or county fair, shall pay the reduced license fee provided for herein (see Table 3 on page 5) for more than five years after July 1, 1970".

Under current state law any racing association that previously handled \$20 million or less in parimutuel wagering that increases its parimutuel handle to more than \$20 million will lose its exemption from paying the higher state license fee rate on the first \$20 million of parimutuel handle (6.10 percent compared to 5.50 percent). Further, such associations will be required to pay

purses to horse owners in accordance with the rates set forth in Section 19611 or 19612 of the Business and Professions Code (see Tables 1 and 2). In addition, this same loss of exemption from the higher license fee rate also applies to racing associations effective July 1, 1975, provided they have been in operation since July 1970, even if the parimutuel pool handled by the association remains at \$20 million or less. The exemption to the statutorily prescribed purses in Section 19614 will be lost only when the parimutuel handle exceeds \$20 million.

Effective July 1, 1975, both California and Peninsula Horse Racing Associations, which have been paying the reduced license fee of 5.50 percent under Section 19614, will pay the license fee provided for in Section 19612 of 6.10 percent on the first \$20 million of annual parimutuel handle. It should be noted that Peninsula Horse Racing Association's parimutuel handle is expected to exceed \$20 million during its current meet which ends on May 18, 1975. If this occurs, Peninsula will pay the 6.10 percent rate prior to July 1, 1975.

Legislation has been introduced to permanently establish a lower state license fee rate of 5.50 percent and continue the exemption from statutory purse payments to horse owners for all racing associations handling \$25 million or less annually, as opposed to the current \$20 million or less. Presumably, purse payments would continue to be paid through negotiated agreements between the racing associations and the horse owners.

Currently, there are seven thoroughbred race meetings in the state that are subject to Section 19611 of the Business and Professions Code, two harness and

quarter horse race meetings that are subject to Section 19612 of the Business and Professions Code, and one harness,^{4/} one quarter horse, eight district or county fairs, and the California State Fair and Exposition, that are exempt from Sections 19611 and 19612 and instead are subject to Section 19614 of the Business and Professions Code.

Only two racing associations currently operating would be affected by the proposed legislation; California Horse Racing Association, a harness race meeting, and Peninsula Horse Racing Association, a quarter horse race meeting. Both associations conduct their meetings at Bay Meadows Race Track in San Mateo, California.

^{4/}California Capital Trotting Association has withdrawn its application to race during the current year. Another association, Golden Bear Raceway, Inc. is tentatively scheduled to conduct a racing meet in place of California Capitol Trotting Association.

INFORMATION REQUESTED BY THE LEGISLATURE

AN INCREASE IN STATE LICENSE FEE RATES ON
JULY 1, 1975 WOULD NOT PLACE CALIFORNIA
HORSE RACING ASSOCIATION IN AN ECONOMIC
POSITION WHICH WOULD PRECLUDE CONTINUED
OPERATION. SUCH INCREASE MAY PLACE PENINSULA
HORSE RACING ASSOCIATION IN AN ECONOMIC POSITION,
DEPENDING UPON CERTAIN MANAGEMENT DECISIONS,
WHICH WOULD PRECLUDE CONTINUED OPERATION.

We have made an independent evaluation of the operating results of California Horse Racing Association and Peninsula Horse Racing Association in order to ascertain the financial impact of an increase in the state license fee rate which becomes effective on July 1, 1975, under provisions of existing law.

We have concluded that if state license fee rates are increased July 1, 1975: (1) California Horse Racing Association will not be placed in an economic position which would preclude continued operation, and (2) Peninsula Horse Racing Association may be placed in an economic position which would preclude continued operation depending upon its management's policies regarding admission charges, lease payments to its landlord, and financial assistance it may receive in the future from a financially successful affiliated quarter horse racing association. In addition, we have concluded that any economic benefit Peninsula Horse Racing Association derives, if state license fee rates are permanently established at 5.50 percent for associations having annual parimutuel handles of \$25 million or less, will be short-term in nature as we project that they will have a parimutuel handle in excess of \$25 million by the year 1977.

California Horse Racing Association

During its recently concluded harness race meeting (December 27, 1974 through February 22, 1975), California Horse Racing Association had a parimutuel handle of \$19,194,160. Of this amount \$15,963,561, or 83.17 percent,^{5/} was paid to winning ticket holders, \$1,055,679, or 5.50 percent, was paid to the state as license fees, \$850,901, or 4.43 percent, was paid to horse owners as purses, and \$1,116,500, or 5.82 percent, was retained by California Horse Racing Association as commissions.

If California Horse Racing Association were not exempt from Section 19612 of the Business and Professions Code during its 1975 racing meet, it would have paid the state an additional \$115,165 in license fees. However, it would have paid \$100,409 less in purses to horse owners because Section 19612 of the Business and Professions Code has a lower purse percentage provision than California Horse Racing Association is currently paying to horse owners as purses under Section 19614 (3.91 percent as compared to 4.43 percent respectively of the parimutuel handle).

We have prepared two projections of net operating income or loss before taxes for California Horse Racing Association for the years 1975 through 1981, which are summarized in Table 4 on page 11.

The two projections shown in Table 4 compare operating results for California Horse Racing Association if (1) state license fee rates are increased and other rates are changed on July 1, 1975 to those specified in Section 19612 of the Business and Professions Code, and (2) state license fee rates are

^{5/} 1.08 percent, or \$207,519 represents "breakage" (see footnote 1/ on page 3) of which approximately one-fourth was retained by California Horse Racing Association and approximately three-fourths was paid to horse owners as part of purses.

permanently established at 5.50 percent for associations having annual parimutuel handles of \$25 million or less.

Table 4

California Horse Racing Association

<u>Fiscal Year Ended</u>	<u>Projected Parimutuel Handle</u>	<u>Projected Net Operating Income Or Loss Before Taxes</u>		<u>State License Fee Under Projection</u>	
		<u>Projection #1</u>	<u>Projection #2</u>	<u>#1</u>	<u>#2</u>
		<u>State License Fee Rates Are Increased And Other Rates Are Changed On July 1, 1975 (Per Sec. 19612 Bus. & Pro. C.)</u>	<u>State License Fee Rate Permanently Established At 5.50 Percent For Associations Having Annual Parimutuel Handles Of \$25 Million or Less</u>		
1975	\$19,194,160 ^{6/}				
1976	20,553,256	\$ 97,982	\$ 95,781	\$1,251,536	\$1,130,429
1977	22,013,550	98,002	94,617	1,334,772	1,210,745
1978	<u>23,579,241</u>	<u>103,314</u>	<u>98,679</u>	<u>1,424,016</u>	<u>1,296,858</u>
	Totals 1976-1978	<u>\$299,298</u>	<u>\$289,077</u>	<u>\$4,010,324</u>	<u>\$3,638,032</u>
1979	25,252,796	102,483	<u>7/</u>	1,519,409	
1980	27,046,453	99,825		1,621,647	
1981	28,969,309	96,690		1,731,250	

As illustrated above, California Horse Racing Association will earn an additional estimated \$10,221 (\$299,298 less \$289,077) in net operating income before taxes for fiscal years 1975-76 through 1977-78 if the state license fee rate

^{6/} 1975 is California Horse Racing Association's last year of exemption under Section 19614 of the Business and Professions Code. Estimated net operating income before taxes for 1975 is \$115,223.

^{7/} Based upon the above projections, California Horse Racing Association will no longer be eligible for the lower state license fee rate after 1978 because its annual parimutuel handle will exceed \$25 million.

is increased on July 1, 1975, as it will be under existing law, to that specified in Section 19612 of the Business and Professions Code. Thus, such an increase would not place California Horse Racing Association in an economic position which would preclude continued operation.

Further, the state will receive an estimated \$372,292 (\$4,010,324 less \$3,638,032) in additional license fees for fiscal years 1975-76 through 1977-78 if the rates are increased. However, horse owners would receive an estimated \$384,115 less in purses for fiscal years 1975-76 through 1977-78 if the license fees are increased and purses are paid in accordance with Section 19612 of the Business and Professions Code.

Peninsula Horse Racing Association

We estimate that Peninsula Horse Racing Association will exceed \$20 million in parimutuel wagering during its current meet, which will conclude May 18, 1975, and therefore will no longer be exempt under Section 19614 of the Business and Professions Code from paying the higher state license fee of 6.10 percent on the first \$20 million of parimutuel handle specified under Section 19612. In addition, Peninsula will be required to pay purses as specified under Section 19612 of the Business and Professions Code.

As a result, Peninsula Horse Racing Association will pay the state an additional \$120,000 in license fee for the 1975 race meetings. We estimate that Peninsula Horse Racing Association will handle \$22,245,000 in parimutuel wagering during its current race meeting and will incur a net operating loss of approximately \$123,225.

We have concluded that in order for Peninsula Horse Racing Association to break even (i.e., revenues equal expenses) during its current meeting it will be necessary for them to have a parimutuel handle of approximately \$24,200,000, which is nearly \$2 million more than we project they will handle.

A significant distinction between Peninsula Horse Racing Association and California Horse Racing Association is that under Section 19614 California Horse Racing Association historically has paid a higher percentage of the parimutuel handle to horse owners as purses than they would under Section 19612 of the Business and Professions Code, whereas under Section 19614 Peninsula Horse Racing Association has always paid a lower percentage of the parimutuel handle as purses than they would under Section 19612 of the Business and Professions Code. Therefore, California Horse Racing Association will be able to recoup all of the increased state license fees imposed by Section 19612 of the Business and Professions Code with offsetting lower purses paid to horse owners, while Peninsula Horse Racing Association will incur both a higher state license fee and higher purse expense under Section 19612 of the Business and Professions Code.

For example, in 1974, Peninsula Horse Racing Association under Section 19614 of the Business and Professions Code had a net operating income before taxes of \$105,260 based on a parimutuel handle of \$17,748,709. However, had Peninsula Horse Racing Association been under Section 19612 of the Business and Professions Code in 1974, they would have a net operating loss before taxes of \$30,205^{8/} because they would have paid an additional \$106,492 in state license fees and an additional \$82,730 in purses to horse owners.

^{8/} Under the terms of its lease agreement, Peninsula Horse Racing Association would have paid \$53,757 less in track rental in 1974 under Section 19612 of the Business and Professions Code.

We have prepared four projections of net operating income or loss before taxes for Peninsula Horse Racing Association for the fiscal years ended 1975 through 1981, which are summarized in Tables 5 and 6 on pages 16 and 17.

The two projections shown in Table 5 compare operating results for Peninsula Horse Racing Association if (1) state license fees and other rates are increased on July 1, 1975 to those specified in Section 19612 of the Business and Professions Code, and (2) state license fee rates are established at 5.50 percent for associations having annual parimutuel handles of \$25 million or less. These two projections are predicated on the assumption that Peninsula Horse Racing Association agrees to pay an increased minimum track rental of \$2,000 per race day and that the current general admission charge of \$1.50 is not increased during the next seven years.

The two projections shown in Table 6 also compare operating results for Peninsula Horse Racing Association under the same conditions, except for the assumption that Peninsula Horse Racing Association will continue to pay a minimum track rental of \$1,000 per race day plus one-half of operating profits in excess of \$1,000 per race day, and that the general admission charge is increased to \$2.00.

Peninsula Horse Racing Association has two more years left on a ten-year lease (with an option to renew for ten more years) which basically provides for a minimum track rental of \$1,000 per race day plus one-half of operating profits in excess of \$1,000 per race day. However, Peninsula Horse Racing Association signed an amendment to the current lease for the 1975 race meeting only which changed the track rental to \$2,000 per race day, regardless of whether Peninsula made a profit or not. This amendment will cost Peninsula Horse Racing Association an additional \$58,000 in track rental during the 1975 race meeting. Officials of Peninsula Horse Racing Association have indicated that they may agree to pay

the \$2,000 per race day track rental for future race meets. It should be noted that a track rental based on the number of race days is to Peninsula Horse Racing Association's advantage only in those situations when their operating profit (exclusive of race track rental) exceeds more than \$2,000 per race day. Otherwise it is to their advantage to pay as small a minimum per day track rental as possible plus a percentage of profits.

Currently, Peninsula Horse Racing Association is charging the lowest general admission charge of any racing association presently in operation in California -- \$1.50. Peninsula Horse Racing Association has not increased its general admission charge since it began operation in 1967 and, in fact, is realizing less in revenue from general admission charges than it did in 1967 because the city admission tax has increased from \$.10 per admission to \$.25 per admission. We estimate that if Peninsula Horse Racing Association raised its general admission charge from \$1.50 to \$2.00 (the minimum charged by any other racing association currently operating in California) they would realize an additional \$80,000 in revenue during the 1975 race meeting and nearly \$100,000 in additional revenue during the 1981 race meeting.

Table 5

Peninsula Horse Racing Association

Projected Net Operating Income or (Loss)
 Before Taxes Assuming an Increased
 Track Rental of \$2,000 Per Race Day
And a Continued General Admission Charge of \$1.50

Fiscal Year Ended	Projected Parimutuel Handle	Projection #1 State License Fee And Other Rates Are Increased On July 1, 1975 (Per Sec. 19612 Bus. & Pro. C.)	Projection #2 State License Fee Rate Permanently Established at 5.50 Percent For Associations Having Annual Parimutuel Handles Of \$25 Million or Less		State License Fee Under Projection	
			#1	#2	#1	#2
1975	\$22,245,000	\$(123,225)	\$ 1,265		\$1,347,965	\$1,223,475
1976	24,073,000	(151,663)	(23,516)		1,452,161	1,324,015
Totals 1975 & 1976		\$(274,888)	\$(22,251)		2,800,126	2,547,490
1977	26,011,000	(153,407)	9/		1,562,627	
1978	28,167,000	(150,457)			1,685,519	
1979	30,452,000	(152,047)			1,815,764	
1980	32,874,000	(155,823)			1,953,818	
1981	35,556,000	(158,479)			2,106,692	

9/ Based upon the above projections, Peninsula Horse Racing Association will no longer be eligible for the lower state license fee rate after 1976 because its annual parimutuel handle will exceed \$25 million.

As illustrated above, Peninsula Horse Racing Association could lose an additional estimated \$252,637 before taxes (\$274,888 less \$22,251) for fiscal years 1974-75 and 1975-76 if state license fee rates are increased to 6.10 percent on July 1, 1975 as provided under existing law (Section 19612).

Table 6

Peninsula Horse Racing Association

Projected Net Operating Income or (Loss)
 Before Taxes Assuming a Continued
 Track Rental of \$1,000 Per Race Day
 Plus One-Half of Operating Profits in Excess of \$1,000 Per Race
 Day and an Increased General Admission Charge of \$2.00

Fiscal Year Ended	Projected Parimutuel Handle	Projection #1 State License Fee And Other Rates Are Increased On July 1, 1975 (Per Sec. 19612 Bus. & Pro. C.)	Projection #2 State License Fee Rate Permanently Established at 5.50 Percent For Associations Having Annual Parimutuel Handles Of \$25 Million or Less		State License Fee Under Projection	
					#1	#2
1975	\$22,245,000	\$ 13,815	\$ 93,905	\$1,347,965	\$1,223,475	
1976	24,073,000	(11,423)	83,124	1,452,161	1,324,015	
Totals 1975 & 1976		\$ <u>2,392</u>	\$ <u>177,029</u>	\$ <u>2,800,126</u>	\$ <u>2,547,490</u>	
1977	26,011,000	(9,967)	<u>10/</u>	1,562,627		
1978	28,167,000	(3,497)		1,685,519		
1979	30,452,000	(1,567)		1,815,764		
1980	32,874,000	(1,823)		1,953,818		
1981	35,556,000	(639)		2,106,692		

10/ Based upon the above projections, Peninsula Horse Racing Association will no longer be eligible for the lower state license fee rate after 1976 because its annual parimutuel handle will exceed \$25 million.

As illustrated above, Peninsula Horse Racing Association would earn an estimated \$174,637 less before taxes (\$177,029 less \$2,392) for fiscal years 1974-75 and 1975-76 if state license fee rates are increased to 6.10 percent on July 1, 1975 as provided under existing law (Section 19612).

As the preceding tables illustrate, Peninsula Horse Racing Association's operating income before taxes for fiscal years 1974-75 and 1975-76 could vary from a profit of \$177,029 to a loss of \$274,888 depending upon the state license fee rates, general admission charges, and race track rental.

It should also be noted that Peninsula Horse Racing Association has in the past received money from an affiliated quarter horse racing association, Horsemen's Quarter Horse Racing Association,^{11/} which conducts quarter horse meets at Los Alamitos Race Track. During 1974, Horsemen's Quarter Horse Racing Association paid for approximately \$40,000 of Peninsula's advertising costs and in addition Horsemen's gave Peninsula a general subsidy of \$100,000. Horsemen's Quarter Horse Racing Association will not be subsidizing Peninsula Horse Racing Association during the current 1975 race meeting. However, this policy could change in the future.

Based upon the above projections and information, we have concluded that Peninsula Horse Racing Association may be placed in an economic position which would preclude continued operation if state license fee rates are increased on July 1, 1975, depending upon its management's policies regarding admission charges, lease payments to its landlord and financial assistance it may receive in the future from Horsemen's Quarter Horse Racing Association. In addition, any economic benefit Peninsula Horse Racing Association derives, if state license fee rates are established at 5.50 percent for associations having annual parimutuel handles of \$25 million or less, will be short-term in nature as its parimutuel handle is projected to exceed \$25 million by the fiscal year ended 1976-77.

^{11/} On October 24, 1974, Peninsula Horse Racing Association and Horsemen's Quarter Horse Racing Association both became subsidiaries of a newly formed holding company -- Quarter Horse Racing, Inc.

TAX ADVANTAGES AVAILABLE TO CALIFORNIA
HORSE RACING ASSOCIATION AND PENINSULA
HORSE RACING ASSOCIATION.

If California Horse Racing Association sustains a net operating loss in any year of operation, this loss, for federal income tax purposes, can be offset against the other income of its individual shareholders. Such a loss for Peninsula Horse Racing Association can be offset against the net operating income of its parent holding company, Quarter Horse Racing, Inc., if an election is made to file a consolidated federal income tax return.

California Horse Racing Association

California Horse Racing Association has elected to file its federal income tax returns using the federal provision commonly known as Subchapter S. This allows the corporation to be taxed as a partnership, whereby income and credits are passed through and taxed directly to the individual stockholders. The corporation in effect pays no federal income tax. California Bank and Corporation tax law does not provide for this advantage. Therefore, state income taxes are paid directly by the corporation.

Peninsula Horse Racing Association

Peninsula Horse Racing Association became a member of a controlled group in 1974. The parent company, Quarter Horse Racing, Inc., exchanged ten shares of its \$100 par value stock for every one share outstanding of Peninsula stock. In addition, Peninsula stockholders received 160 promissory notes each valued at \$1,000 with interest at 8-1/2 percent per annum, payable in ten equal annual installments. The purchase price paid for the Peninsula Horse Racing

Association stock by Quarter Horse Racing, Inc., exceeded the fair value of Peninsula's net assets by \$230,746, and this was recorded as good will on the books of Quarter Horse Racing, Inc. The other member of the controlled group, Horsemen's Quarter Horse Racing Association, conducts quarter horse racing meetings at Los Alamitos Race Course, and was acquired for a purchase price which approximated the fair value of its assets.

The parent company, Quarter Horse Racing, Inc., can elect for federal income tax purposes to file a consolidated income tax return. This allows any taxable losses sustained by Peninsula Horse Racing Association to be offset against taxable income of Horsemen's Quarter Horse Racing Association.

During the years ending November 30, 1973 and November 30, 1974, Horsemen's Quarter Horse Racing Association had net operating income before taxes of \$376,938 and \$261,357 respectively.

THE OPERATING REVENUES AND EXPENSES OF EACH ASSOCIATION WERE DETERMINED TO BE ACCURATELY REPORTED AND, WHEN COMPARED ON A PERCENTAGE BASIS TO OTHER RACING ASSOCIATIONS, THE EFFICIENCY OF OPERATIONS WAS DEEMED TO BE REASONABLE.

Our evaluation of the accuracy of reported operating revenue and the accuracy and propriety of reported operating expenses of California Horse Racing Association and Peninsula Horse Racing Association for their fiscal years ended in 1972, 1973, 1974 as well as the current fiscal year, did not disclose any improprieties or inaccuracies of a material nature in any of these years.

Our evaluation included a review of work performed by independent certified public accountants certifying the financial statements of the two associations, a review of accounting controls, and our independent verification of operating revenues and expenses. We also compared the results of operations of California Horse Racing Association and Peninsula Horse Racing Association with the operating results of all other California horse racing associations. Revenues and expenses were compared both as a percentage of total parimutuel handle and as a percentage of total revenues and expenses. We have concluded, based on our comparative analysis, that both associations are operating efficiently in relation to industry-wide operating results.

SUMMARY OF COMMENTS OF RESPONSIBLE
OFFICIALS OF CALIFORNIA HORSE RACING
ASSOCIATION AND PENINSULA
HORSE RACING ASSOCIATION

1. If California Horse Racing Association paid the lower purses to horse owners as provided in Section 19612 of the Business and Professions Code, the quality horses would race at other race meetings where the purses are higher (e.g., Yonkers, Liberty Bell or Roosevelt). The absence of the quality horses would result in lower parimutuel handles for California's race meetings.
2. At present 90 percent of horse owners are either just breaking even or losing money. Therefore, any reductions in purses paid to horse owners would only aggravate this situation and force many horse owners to get out of the business.
3. It is highly unlikely that California Horse Racing Association will exceed \$25 million annual parimutuel handle in the foreseeable future because current betting and attendance trends simply cannot continue indefinitely.
4. Peninsula Horse Racing Association must impose a lower general admission charge because of competition from Golden Gate Fields. In fact, Peninsula has instituted Sunday and Monday racing to avoid direct competition with Golden Gate Fields (which races Tuesday through Saturday) in spite of having to pay double time salaries for Sunday racing.

If the labor unions demand triple time pay for Sunday racing, Peninsula will have to abandon Sunday racing and incur more direct competition from Golden Gate Fields. In that eventuality, both attendance and parimutuel handle for the Peninsula meet would be adversely affected.

5. The lower general admission charge imposed by Peninsula Horse Racing Association results in increased attendance with corresponding increases in the parimutuel handle. Any increase in the general admission charge by Peninsula would decrease attendance by an unknown quantity.
6. The city admissions tax is higher for some race meetings than it is for Peninsula. Therefore, these other associations need to charge more to cover the higher tax.
7. California Horse Racing Association is in jeopardy of losing their Subchapter S status due to deaths of stockholders.
8. Projected losses for Peninsula Horse Racing Association are not a tax shelter for Quarter Horse Racing, Inc., because Peninsula's losses are out-of-pocket cash losses as opposed to paper losses such as depreciation and amortization.
9. Any projections of operating income or loss for the next seven years are highly questionable because of (1) the uncertainty of future economic conditions, (2) future weather conditions, (3) the possibility of off-track betting being legalized, and (4) the possibility of greyhound dog racing being legalized, among other things.