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THE TAXATION OF IMAGE RIGHTS IN SOUTH AFRICA: VALIDITY OF TAX MINIMISATION SCHEMES

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Summary

Sport, undeniably, plays a large role in society today. Over the years it has developed into an immensely lucrative industry, not only on the field of play but also off the field. In the modern-day digital environment where a vast portion of the world population have access to sport broadcasting platforms such as SuperSport and social media platforms such as Instagram, many sport stars have become household names and cultural icons.

Most of the leading commercial brands are spending large amounts of money in the form of sponsorships and endorsements to secure association of their brand with the image of sports stars. The commercialisation of sports stars' image rights has created a whole new source of income for them. Cristiano Ronaldo's main income for the year 2020 is a salary of approximately $60 million (approx. R1 billion), slightly less than the previous year due to a 30% pay cut in the wake of the coronavirus pandemic. His second source of income is derived from endorsements, which on its own is worth an additional $45 million (approx. R760 million). These significant streams of income can temp sport stars to enter into creative schemes which attempt to minimise the high taxes imposed on them. One such scheme is the establishment of a dedicated company to manage their image rights and to receive monies paid for the use of their image rights. These Image Rights Companies (IRCs) are typically registered in low tax jurisdictions.

This dissertation evaluates whether South Africa is currently in a position to regulate such schemes. As a basis, a legal comparison was performed between two prominent sports nations namely the United Kingdom and Spain.

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Chapter 1: Introduction

1.1 Background

Sport, undeniably, plays a big role in society today. It has developed over the years into an industry of its own and its players have become more valuable, not only on the field but also off the field. Sport stars such as Lionel Messi and Cristiano Ronaldo earn millions of Euros, which is evident from the contracts that they enter into. Messi's contract with FC Barcelona for 2020/21 stipulated that he will earn $72 million (approx. R1.3 billion) annually in wages.[1] In August 2020 Messi indicated that he wanted to transfer from Barcelona and was offered a contract from Man City in the tune of £450 million (approx. R10 billion) over a period of five years and on top of that £225 million (approx. R5 billion) in bonuses.[2] The star elected to remain at Barcelona.[3] Ronaldo's contract with Juventus, which he signed in 2018, is a four-year deal worth $64 million (approx. R1 billion) in wages annually.[4] These enormous amounts are only what they will earn on the field of play.

As far as off the field of play is concerned, the concept of "image rights" must be noted. The term image rights are defined as:

> "… the ability of an individual to exclusively control the commercial use of his name, physical/pictorial image, reputation, identity, voice, personality, signature, initials or nickname in advertisements, marketing and all other forms of media".[5]

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1 Forbes '2020 Celebrity 100 Earnings' updated on 6 April 2020 https://www.forbes.com/profile/lionel-messi/#4813a5ab5e9f (Accessed on 1 September 2020).

2 The Sun 'Transfer news LIVE: Man City 'offer £450m contract' updated on 1 September 2020 https://www.thesun.co.uk/sport/12537022/transfer-news-live-messi-man-city-barcelona/ (Accessed at 1 September 2020).

3 The New York Times 'In a Reversal, Lionel Messi Says He Will Stay With Barcelona' published on 4 September 2020 by T Panja https://www.nytimes.com/2020/09/04/sports/soccer/lionel-messi-barcelona.html (Accessed on 25 November 2020) and Sky Sports 'Lionel Messi to stay at Barcelona next season despite transfer row' published on 5 September 2020 https://www.skysports.com/football/news/11833/12060383/lionel-messi-to-stay-at-barcelona-next-season-despite-transfer-row (Accessed on 25 November 2020).

4 Forbes '2020 Celebrity 100 Earnings' updated on 6 April 2020 https://www.forbes.com/profile/lionel-messi/#4813a5ab5e9f (Accessed on 1 September 2020).

5 R Cloete (ed.) *Introduction to Sports Law in South Africa* (2005) 176.

The use of someone's image rights can essentially be explained as the practise of appropriating someone's personality.[6] This practice is not a new concept and is recorded as far back as 1843 in the United Kingdom, where a Mr Cockle's Antibilious Pills were recommended by some upstanding members of the community, including *inter alia*, dukes and bishops. The advertisers then sought to make these members official endorsers of this product in order to enhance the sale thereof.[7] It naturally follows that with the introduction of new technology such as television in the second half of the twentieth century, the awareness of celebrities and sport stars has grown immensely.[8] In our modern society today, people have become transfixed with sport stars, which led to the image rights of individual sport stars such as Messi and Ronaldo to become commodities as these rights are now being exploited by their clubs and other third parties in order to enhance their brand image and to promote the sale of their products.[9] This use of the image rights of superstars had led to a whole new source of income for them.[10] Messi's contract with FC Barcelona for example granted him exclusive image rights on top of his already lucrative salary. Messi's net worth in 2020 is estimated to be $400 million (approx. R6.6 billion) which amount is made up from a combination of his playing contract, endorsements deals and investments.[11] His endorsements is believed to be worth $32 million (approx. R530 million) in 2020.[12] Ronaldo is reported to earn the most off-field earnings in soccer with his most significant sponsorship being Nike. The exact value of that sponsorship is not known, but it is said to be in the excess of $1 billion (approx. R16.6 billion) in total.[13] His

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6 H Beverley-Smith *The Appropriation of Personality* (2002) 3.

7 Beverley-Smith (n 4 above) 3.

8 S Cornelius 'Image Rights in South Africa' 2008/3-4 *The International Sports Law Journal* 71.

9 R Cloete 'The Taxation of Image Rights: A Comparative Analysis' (2012) 45 *De Jure* 556 (hereafter the Cloete Article) read together with Cornelius (n 6 above) 71.

10 Cornelius (n 6 above) 71.

11 Clutch Points 'Lionel Messi's net worth in 2020' by Julius Tabios updated 21 July 2020 https://clutchpoints.com/lionel-messi-net-worth-in-2020/#:~:text=Lionel%20Messi's%20net%20worth%20in%202020%20(estimate)%3A%20%24400%20million&text=Forbes%20ranked%20Messi%20third%20among,at%20an%20astonishing%20%24127%20million. (Accessed on 1 September 2020).

12 Forbes '2020 Celebrity 100 Earnings' updated on 6 April 2020 https://www.forbes.com/profile/lionel-messi/#4813a5ab5e9f (Accessed on 1 September 2020).

13 Goal 'What is Cristiano Ronaldo's net worth and how much does the Real Madrid star earn?' by Oli Platt 14 February 2018 http://www.goal.com/en-za/news/what-is-cristiano-ronaldos-net-worth-and-how-much-does-the/wpqwcm08p2o916g11efo6et6z (Accessed on 7 February 2018).

endorsements for 2020 alone is believed to be worth $44 million (approx. R730 million).[14] His net worth is estimated to be $450 million (approx. R7.4 billion).[15]

This practise is not limited to soccer players alone. South African cricketing icon, AB de Villiers has made news headlines for the impressive salary that he earns playing for The Royal Challengers Bangalore in the Indian Premier League (hereafter 'IPL'). His 2020 IPL salary was confirmed during February 2020 to be an astonishing $1.5 million (approx. R24.9 million) for the season.[16] In 2017, de Villiers became the brand ambassador for Montblanc, representing the brand in both South Africa and India.[17] Although the exact value of this sponsorship is not known, the total value of his endorsement earnings is said to amount to $500 00 (approx. R8.4 million).[18] His net worth in 2020 is reportedly $3 million (approx. R49.9 million).[19]

Mention needs to be made to the richest sport star in South Africa, Ernie Els, whose net worth in 2020 is estimated to be $75 million (approx. R1.2 billion).[20] Els is known for making large sums of money off the field of play through endorsements by Boeing, Callaway and many others. Golf Digest the magazine approximated that he earns around $14 million (approx. R175 million) off the golf course.[21]

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14 Investopedia 'This is Cristiano Ronaldo's Net Worth' by Anika Varity updated on 4 July 2020 https://www.investopedia.com/news/net-worth-cristiano-ronaldo/#:~:text=According%20to%20Forbes%2C%20the%20soccer,net%20worth%20at%20%24450%20million. (Accessed on 1 September 2020).

15 Forbes '2020 Celebrity 100 Earnings' #5 Lionel Messi updated on 6 April 2020 https://www.forbes.com/profile/lionel-messi/#4813a5ab5e9f (Accessed on 1 September 2020).

16 Sportekz 'IPL 2020 Player Salaries' updated on 24 February 2020 https://www.sportekz.com/cricket/ipl-2020-players-salaries/ (Accessed on 1 September 2020).

17 Read in general People Magazine 'Montblanc announces South African sport star "A" as brand ambassador' by M Sekhu 28 March 2017 https://citizen.co.za/lifestyle/1469349/montblanc-announces-ab-de-villiers-brand-ambassador/ (Accessed on 1 May 2018); Economic Times 'Montblanc signs South African sport star "A" as brand ambassador' by A Chaturvedi 29 March 2017 https://economictimes.indiatimes.com/industry/services/advertising/montblanc-signs-ab-de-villiers-as-brand-ambassador/articleshow/57896345.cms (Accessed on 1 May 2018).

18 Sportekz 'The 20 Highest Paid Cricket Players in World 2020' updated on 6 June 2020 https://www.sportekz.com/list/highest-paid-cricketers-2020/ (Accessed on 1 September 2020).

19 Sportekz 'The 20 Highest Paid Cricket Players in World 2020' updated on 6 June 2020 https://www.sportekz.com/list/highest-paid-cricketers-2020/ (Accessed on 1 September 2020).

20 Deemples 'Top 10 Richest Golfers Of All Time' updated 22 April 2020 https://deemples.com/top-10-richest-golfers/ (Accessed on 1 September 2020).

21 Business Insider '20 Golfers Who Make More Money Endorsing Products Than Playing Golf' by T Manfred 22 January 2013 http://www.businessinsider.com/highest-paid-golfers-endorsements-2013-1?IR=T#sergio-garcia-10-million-off-the-course-17 (Accessed on 15 May 2018).

Due to these relatively high amounts of income, these sport stars may be tempted to enter into creative schemes to try and diminish high taxes levied against them. Both Messi and Ronaldo have used "image rights companies" (hereafter referred to as "IRC") to manage their image rights. All income derived from licensing and using the image rights of the relevant sport personality are then received by the said company. For tax purposes, these IRCs are registered in so called 'tax havens' so they can receive the most favourable tax treatment.[22] Both Messi and Ronaldo have faced legal problems because of the use of such IRCs to avoid taxes.

Messi had been convicted of tax fraud in 2016 for having defaulted on tax payments for his image rights three times between 2007-2009. He diverted his image rights moneys to offshore companies in Belize and Uruguay, which then led to direct tax evasion.[23] Ronaldo is another soccer player that faced similar charges where it was alleged that he concealed income from the sale of image rights through a mitigation scheme in which he diverted money from his image rights through Ireland to a tax haven in the British Virgin Islands.[24] He reached a settlement agreement with the Spanish tax authorities in 2019.[25] These case studies will discuss in further detail in Chapter 4.

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22 Read in general Planet Futbol 'Ronaldo's tax fraud charges, the Beckham Law and how his case compares to Messi, Neymar' by M Mccann 15 June 2017 https://www.si.com/planet-futbol/2017/06/15/cristiano-ronaldo-tax-fraud-spain-beckham-law-real-madrid-messi-neymar (Accessed on 5 March 2019); Forbes 'Tax Lessons From Soccer's Messi & Ronaldo Tax Evasion Cases' by R Wood 16 June 2017 https://www.forbes.com/sites/robertwood/2017/06/16/tax-lessons-from-soccers-messi-ronaldo-tax-evasion-cases/#1c8f85856ff4 (Accessed on 1 March 2018); The Guardian 'Cristiano Ronaldo denies €14.7m tax evasion in Madrid court' by S Burgen 31 July 2017 https://www.theguardian.com/football/2017/jul/31/cristiano-ronaldo-denies-tax-evasion-madrid-court (Accessed on 1 March 2018); Times Live 'Ronaldo appears in court over tax evasion claims' by AFP 31 July 2017 https://www.timeslive.co.za/sport/soccer/2017-07-31-ronaldo-appears-in-court-over-tax-evasion-claims/ (Accessed on 16 February 2018); Independent 'Cristiano Ronaldo claims tax investigations are only because 'he's Cristiano Ronaldo'' by Sport Staff 1 August 2017 http://www.independent.co.uk/sport/football/european/cristiano-ronaldo-tax-investigation-case-prison-jail-real-madrid-a7870516.html (Accessed on1 March 2018).

23 Grup 14 'Explaining Lionel Messi's problems with the Spanish Tax Agency' by Heimo 14 July 2017 https://grup14.com/article/explaining-lionel-messi-s-problems-with-the-spanish-tax-agency together with 'Express New Service 'How image rights landed Lionel Messi, his father in trouble' 25 May 2017 http://indianexpress.com/article/sports/football/messi-jail-messi-tax-evasion-how-image-rights-landed-messi-his-father-in-trouble-4672399/ (Accessed on 26 February).

24 The Guardian 'Cristiano Ronaldo denies €14.7m tax evasion in Madrid court' by S Burgen 31 July 2017 https://www.theguardian.com/football/2017/jul/31/cristiano-ronaldo-denies-tax-evasion-madrid-court (Accessed on 1 March 2018).

25 EL Païs 'Spain's tax authority accepts Cristiano Ronaldo deal: €19 million and two-year suspended jail term' published on 26 July 2018

It is evident from these recent cases that with the increase in value of image rights, taxpayers have been reported to enter into schemes that effectively limit or reduce their potential tax liability.

1.2 Rationale of the study

As apparent from the recent dates in the two case studies above, tax minimisation schemes with regards to image rights of sport stars are new and developing. It is reasonable to assume that such schemes are currently being entered into around the world by other sport stars, which South Africa will be no exception of. The regulation of the status of image rights have been heavily discussed in other countries such as the United Kingdom[26] and Spain[27], but in comparison there is little academic research on this topic at the moment of writing in South Africa.

This study will seek to add to this particular subject by:

- Evaluating whether South Africa is currently in a position to regulate a scheme where a sport star creates an image rights company to which he assigns his image rights and from where the star indirectly receives an income;
- Determining whether such scheme constitutes a tax evasion scheme or rather a scheme in terms of the South African General Anti Avoidance Rules; and

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https://english.elpais.com/elpais/2018/07/26/inenglish/1532613639_389065.html (Accessed on 22 September 2020).

26 See generally P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*; R Haynes 'Footballers' Image Rights in the New Media Age' (2007) 7(4) *European Sport Management Quarterly*; C Coors 'Sports Image Rights in the UK: Countering tax evasion in the football industry' (2017) 8(1) *Global Sports Law and Taxation Reports*; K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Report* and HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

27 See generally Senn Ferrero Sport & Entertainment 'Spanish tax situation of image rights' by E Montejo http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights (Accessed on 22 September 2020); L. J. D. Garcia 'Image Rights: Spanish Taxation' (2017) EPFL Legal Newsletter #5 https://us12.campaign-archive.com/?u=6e691aba6d240b5f49d576cea&id=d65d52eb2d (Accessed on 22 September 2020); Y. V. Moraga & A Sarrias 'Sport Image Rights in Spain' (2010) 3-4 The International Sport Law Journal; J de Dios et al 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* and Sport and Taxation 'Image Rights: Cristiano Ronaldo facing €15 million tax fraud case in Spain' by I Blackshaw posted on 13 June 2017 https://www.sportsandtaxation.com/2017/06/image-rights-cristiano-ronaldo-facing-e15-million-tax-fraud-case-in-spain/ (Accessed on 12 November 2020).

- Determining whether South Africa would be able to penalise such tax avoidance schemes where necessary.

There will be an interest from the South African Revenue Services in such a regulation, having regard to the R304 billion revenue shortfall for 2020/2021.[28]

Another motivation for regulating such schemes would be the notion of equality. It could not be perceived as treating all equal if there were to be certain minimisation schemes available to sport stars to separate income from their image rights from that of their personal income, whilst in the same circumstances another taxpayer would be expected to include all their moneys as income and therefore being liable for higher income tax.

1.3 Scope and Limitations of the Study

1.3.1 Scope

This research consists of a comprehensive analysis into the current regulations and laws in place with regards to professional sport players in South Africa, in specific, how the money earned from their image rights are taxed. In Chapter 4, case studies in leading countries on this topic such as the United Kingdom and Spain will be discussed. Chapter 5 will be a conclusion.

1.3.2 Limitations

This study will only take into account the applicable law up to 2020.The study will further be limited to the taxation of image rights of professional sports players and will therefore not have regard to amateur players.

Case studies in the South Africa, the United Kingdom and Spain will be discussed, and no other country will be taken into account. The United Kingdom and Spain will be discussed fully in Chapter 4.

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[28] Business Tech 'South Africa's tax base in shrinking' posted on 7 October 2020 https://businesstech.co.za/news/finance/438917/south-africas-tax-base-is-shrinking-2/#:~:text=The%20unemployment%20figures%2C%20as%20well,Who%20pays%20South%20Africa's%20taxes%3F (Accessed on 19 November 2020).

It is noted that this study could be applicable to all entertainers in all the entertainment industries. The research conducted in this study is however limited to sport stars and the schemes that they enter into.

It is noted that when the sport star assigns his image rights to an IRC the provisions of Section 7 of the Income Tax Act 58 of 1962 could be application. For the purpose of this dissertation it is accepted that the star fully disposes of the ownership of his image rights at an arm's length price, when he assigns it to the IRC and the provisions in Section 7 of the Income Tax Act 58 of 1962 will therefore not be discussed.

It is noted that the provisions of contributed tax capital as defined in Section 1 of the Income Tax Act 58 of 1962 could be applicable to the shares that the sport star hold in the IRC. It will however be accepted for the purpose of this dissertation that the sport star will only receive a distribution from the IRC in the form of a dividend and contributed tax capital will not be discussed.

1.4 Methodologies

The research methodology adopted in this study will constitute a qualitative research consisting of a critical analytic review of the relevant legislation, regulations, case law and literature. A legal comparative analysis will be conducted between South Africa, United Kingdom and Spain. In South Africa there will be a detailed discussion on the applicable legislation. This topic has become well associated with soccer players, as will be demonstrated throughout this dissertation. It is for this reason that Spain and the United Kingdom, both being well-known for their soccer, will be used to compare with South Africa's current position on image rights. These two jurisdictions also have a number of case law on the topic whilst there is a significant lack of case law on the topic in South Africa.

1.5 Research Questions

This research will respond to the following questions:

1. What is the status of image rights in terms of intellectual property law, as well as sports law in South Africa?;

2. What South African regulations are currently in place to regulate the taxation of the image rights of a sport star in the country?

3. What schemes do a sport star enter into to minimise their tax liability in the jurisdiction in which they are a tax resident?

4. How does South Africa regulate these types of tax minimisation schemes entered into by resident sport stars in relation to their image rights?;

5. How do Spain and the United Kingdom currently deal with tax minimisation schemes, specifically entered into by sport stars in relation to their image rights?; and

6. What lessons, if any, can be learnt from jurisdictions such as the United Kingdom and Spain regarding the taxation of image rights?

1.6 Structure

To respond adequately to the above research questions this research is structured as follows:

1. Chapter 1 contains the research problem, research questions, methodology and limitations of the study.

2. Chapter 2 contains definitions and an analysis of important concepts. Image rights are firstly defined in terms of laws pertaining to intellectual property after which it is defined in the context of sports law. A discussion of the basic set-up of an IRC structure is discussed and depicted in a diagram.

3. Chapter 3 focuses on South African tax laws and how the taxation of image rights are currently regulated. The Guide on the Taxation of Professional Sports Clubs and Players are examined together with applicable case law. There is a discussion on international anti-avoidance regulations and specific anti-avoidance provisions.

4. Chapter 4 consists of three parts. Part A focuses on Global tax anti-avoidance provisions. Part B focuses on the taxation of image rights in Spain, where the IRC structures entered into by Lionel Messi and Cristiano Ronaldo is analysed as two case studies. Part C discusses the taxation of image rights in the United Kingdom where the IRC structure of the sport star Geovanni Deiberson Maurício Gómez is analysed, together with all other recent developments in image rights in the United Kingdom.

5. Chapter 5 concludes this research by providing a summary of the status of image rights of sport stars in the context of tax together with recommendations.

Chapter 2: An Analysis of Important Definitions and Concepts in relation to Image Rights

To answer the broader question of the validity of tax minimisation schemes entered into by sport stars through the use of image rights companies, one must first determine what the sport star's "image rights" entails. In this chapter the term "image rights" will be dissected. Firstly, this term will be examined in the light of intellectual property law. An illustrative example of what constitutes image rights will be presented in this chapter, using the name of the famous soccer player, Lionel Messi. Secondly, image rights will be defined and explained in the context of sports law.

2.1 Image Rights

2.1.1 Intellectual Property Law: Copyrights vs. Trademark

The term "image rights"[29] is not currently expressly recognised in South African law.[30] To determine where and how 'image rights' can be integrated into existing regulations, the law pertaining to Intellectual Property has to be carefully studied.

2.1.1.1 Copyright

Copyright differs from other intellectual property rights as it subsists automatically once it has been created, provided that the work complies with the requirements for originality and has been created by a qualified person. As a result, copyright do not have to be registered in order to come into force.[31] Copyright is regulated by the Copyright Act 98 of 1978 (hereinafter referred to as "the Copyright Act").[32]

Copyright grants the author of an original work an exclusive statutory right for a limited duration for the rendering of performance of certain dealings or acts in relation to

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29 Also known as "right of privacy" in the United Kingdom, "right of publicity" in the United States and the "rights of personality" in Continental Europe see generally R Cloete 'The Taxation of Image Rights: A Comparative Analysis' (2012) 45 *De Jure* 557.

30 P.K Mehta *The Tax Treatment of Image Rights of Professional Sportspersons in South Africa*, published MCom, University of Witwatersrand, Johannesburg 12 and R Sikwane & Z Gardner 'A Brief Introduction to Image Rights in South Africa' senior associates at Edward Nathan Sonnebergs. Article was found on www.ens.co.za.

31 E Bergenthuin & C Gibson 'South Africa: Copyright Laws and Regulations 2020' published on ICLG.com https://iclg.com/practice-areas/copyright-laws-and-regulations/south-africa (Accessed on 22 August 2020).

32 O Dean *et al Introduction to Intellectual Property Law* (2014) 3,4.

specified works. It also prevents others from performing those acts in relation to the protected works.[33]

The Copyright Act does not provide a definition for "image rights". To determine whether "image rights" may be protected under the Copyright Act, Chapter 2 of the Act specifying types of "works" that are eligible for copyright, should be considered. To qualify as a "work", the subject matter must be of sufficient substance to reasonably justify being attributed a form of exclusivity.[34]

There are nine specific classes of work in which copyright can subsist, namely: literary works; musical works; artistic works; cinematograph films; sound recordings; broadcasts; programme-carrying signals; published editions and computer programs.[35] For example, Lionel Messi's image rights will constitute his name, which may include both a word element (the surname "Messi") and a figurative element (for example a styled "M" placed above the surname).[36] From the outset, it does not appear that image rights can be unambiguously classified under any of these categories except possibly the "literary works" class. For the purpose of this dissertation, only this class will be examined in detail.

Literary work includes, *inter alia*, novels, stories, dramatic works, textbooks, letters, lectures, speeches, tables and compilations of data stored or embodied in a computer or a medium used in conjunction with a computer, but shall not include a computer program.[37] In a 1990 Witwatersrand case of *Kinnor (PTY) Ltd v Finkel*[38] the court dealt with the question of whether a name could be classified as a literary work. In this case the applicant sold watches bearing a mark, "LePacer", with the letter "P" having an elongated loop extending the length of the whole word, which was also used in

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33 O Dean *et al Introduction to Intellectual Property Law* (2014) 3 and A Copeling 'The Nature and Object of Copyright' (1969) 242 *Comparative and International Law Journal of Southern Africa, Volume 2, Issue 2* 242.

34 O Dean *et al Introduction to Intellectual Property Law* (2014) 8.

35 Section 2 (1) of the Copyright Act 98 of 1978.

36 M Mancinella 'The visual, the phonetic and the famous: trademark similarity in the wake of Messi v EUIPO' (2018) 40 *European Intellectual Property Review* 666.

37 See Section 1 of the Copyright Act 98 of 1978 for a full list.

38 *Kinnor (Pty) Ltd v Finkel* 1990 (352) JOC (W) and M Stranex 'Judgments on Copyright' (2016) 352 *The Law Publisher CC* CK92/26137/23.

advertising material.[39] The applicant claimed that he held the copyright in the mark that he created and indicated to the court that it was a product of his own "skill and ingenuity".[40] The court concluded that a name is generally not of sufficient substance to warrant a copyright protection as the words "LePacer", in this instance, was deemed to be meaningless and could not qualify as a literary work.[41] The court referred to *Exxon Corporation v Exxon Insurance Consultants Ltd*[42] (the "Exxon case") and agreed with the finding of the latter case that "there cannot be copyright in an invested name or word …. it is simply an artificial combination of letters of the alphabet, and, I add, without any literary content."[43] In *South African Football Association v Stanton Woodrush (Pty) Ltd*[44] the court also considered whether the nickname "Bafana Bafana" could be protected under copyright and by also referring to the Exxon case again confirmed that a name does not qualify as a literary work within the meaning of the Copyright Act.[45]

As a result, it would be an impossible task to try and prove how image rights could qualify as one of the above nine classes of "works" for copyright purposes, based on the fact that Lionel Messi's name, for example, would not fit into any of these "works" categories. Even if image rights fall within the ambit of one of the nine classes of "works", such work may not necessarily qualify for copyright purposes as there are certain further requirements which must be met before a copyright can subsist.[46]

The primary requirement is that it must be "original". This can be drawn from the heading of Chapter 1 of the Copyright Act which specifically refers to copyright in "original" works, but the aforementioned Act fails to provide any definition of this concept or other guidelines that could serve to clarify its meaning.[47] The work must not have been taken or copied from a prior work of another person, but rather it must

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39 *Kinnor (Pty) Ltd v Finkel* 1990 (352) JOC (W) and M Stranex 'Judgments on Copyright' (2016) 352 *The Law Publisher CC* CK92/26137/23.
40 *Kinnor (Pty) Ltd v Finkel* 1990 (352) JOC (W) 357,359 and 360.
41 *Kinnor (Pty) Ltd v Finkel* 1990 (352) JOC (W)361.
42 *Exxon Corporation v Exxon Insurance Consultants Ltd* 1982 RPC 69.
43 *Kinnor (Pty) Ltd v Finkel* 1990 (352) JOC (W) 361.
44 *South African Football Association v Stanton Woodrush (Pty) Ltd t/a Stan Smidt & Sons* 2003 (3) SA 313 (SCA).
45 *South African Football Association v Stanton Woodrush (Pty) Ltd t/a Stan Smidt & Sons* 2003 (3) SA 313 (SCA) para 19.
46 O Dean *et al Introduction to Intellectual Property Law* (2014) 8.
47 O Dean *et al Introduction to Intellectual Property Law* (2014) 16.

have been as a result of the author's own skill and labour.[48] However, the work can still qualify as "original" if it was copied from previous work, provided that the author added a sufficient amount of his own skill and labour to the new end product.[49] The test for originality is therefore a subjective one, in which one considers the labour and skill that the author applied to obtain the end result. With novelty not being a requirement to qualify for copyright purposes, the standard applied for originality in copyright law, appears to be low.[50]

The second requirement is that the work must be reduced to a material form. Section 2(2) of the Copyright Act states that "a work, except a broadcast or programme-carrying signal, shall not be eligible for copyright unless the work has been written down, recorded, represented in digital data or signals or otherwise reduced to material form."[51] There can be no copyright in an idea on its own. The idea must be expressed in one or other material form for copyright to subsist.[52]

The third requirement is that the author of a work was a "qualified person" at the time the work or a substantial part thereof was made. Section 3(1) (a) and (b) of the Copyright Act states that a "qualified person" in the case of an individual is "a person who is a South African citizen or is domiciled or resident in the Republic to which the operation of the copyright has been extended by proclamation, and in the case of a juristic person, a body incorporated under South African law or under the law of a country to which the operation of the Copyright Act has been extended by proclamation".[53]

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48 O Dean *et al Introduction to Intellectual Property Law* (2014) 16 and E Bergenthuin & C Gibson 'South Africa: Copyright Laws and Regulations 2020' published on ICLG.com https://iclg.com/practice-areas/copyright-laws-and-regulations/south-africa (Accessed on 22 August 2020).

49 M Louw 'Suggestions for the Protection of Star Athletes and Other Famous Persons against Unauthorised Celebrity Merchandising in South African Law' (2007) 19 S *AFR. Mercantile L.J* 285.

50 E Bergenthuin & C Gibson 'South Africa: Copyright Laws and Regulations 2020' published on ICLG.com https://iclg.com/practice-areas/copyright-laws-and-regulations/south-africa (Accessed on 22 August 2020).

51 Section 2 (2) of the Copyright Act 98 of 1978.

52 A Copeling 'The Nature and Object of Copyright' (1969) 243 *Comparative and International Law Journal of Southern Africa, Volume 2, Issue 2* 242 and E Bergenthuin & C Gibson 'South Africa: Copyright Laws and Regulations 2020' published on ICLG.com https://iclg.com/practice-areas/copyright-laws-and-regulations/south-africa (Accessed on 22 August 2020).

53 Section 3(1) (a) and (b) of the Copyright Act 98 of 1978 and E Bergenthuin & C Gibson 'South Africa: Copyright Laws and Regulations 2020' published on ICLG.com https://iclg.com/practice-areas/copyright-laws-and-regulations/south-africa (Accessed on 22 August 2020).

It is therefore concluded by the author that image rights will not be protected under the Copyright Act. This conclusion is supported by the fact that should Lionel Messi's name be considered to constitute an original literary work, then no one would be able to reproduce or broadcast his name without infringing on his copyright.[54] The practical implication of this would be that every journalist who reports about Messi and uses his name in an article, would infringe on his copyright. It would therefore not be practical that image rights of sport stars be protected under the Copyright Act.[55]

2.1.1.2 Trade Mark

Trade marks are governed by the Trade Marks Act 194 of 1993 (hereafter referred to as "Trade Marks Act")[56] and common law. A trade mark is defined in the Trade Marks Act as "a mark used by a person in relation to goods or services for the purpose of distinguishing those goods or services from the same kind of goods or services connected in the course of trade with any other person".[57] A trade mark, which generally includes brand names, slogans or logos is the means by which a trader conveys the message that they own that specific product or service.[58] Unlike copyright, trade marks can be registered and the Trade Marks Act regulates the registration system.

There is a two-fold significance for a sport star to register his image rights as a trade mark.[59] Firstly, the star indicates to third parties that he is open to authorised exploitation of his image rights for the class of goods and services supplied in terms

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54 *South African Football Association v Stanton Woodrush (Pty) Ltd t/a Stan Smidt & Sons* 2003 (3) SA 313 (SCA) para 19.

55 M Louw 'Suggestions for the Protection of Star Athletes and Other Famous Persons against Unauthorised Celebrity Merchandising in South African Law' (2007) 19 S *AFR. Mercantile L.J* 285 and K Roshana 'Ambush marketing and the protection of the trade marks of international sports organisations – a comparative view' (2008) 41 *Comparative and International Law Journal of Southern Africa* 27.

56 Trade Marks Act 194 of 1993.

57 Section 2 of the Trade Marks Act 194 of 1993.

58 D Swart 'Introduction to the law of trade marks in South Africa' written 13 September 2004 https://news.wine.co.za/news.aspx?NEWSID=5981 (Accessed on 22 August 2020) and O Dean *et al Introduction to Intellectual Property Law* (2014) 79.

59 T Ahmad & S.R. Swain 'Celebrity Rights: Protection under IP Laws' (2011) 16 *Journal of Intellectual Property Rights* 10 and S.A van Zijl (2016) The Taxation of Image Rights in South Africa, unpublished LLM dissertation, University of the Free State 9.

of his registered image rights.[60] Secondly, the star obtains a statutory defence against third parties who exploit his image rights without his authorisation.[61]

The essential element of a registrable trade mark is that the relevant mark of one trader's product or service is distinguishable from the product or service of another trader.[62] This will be achieved if, "at the date of the application for registration, the mark is an inherently distinguishing mark or it is capable of being distinguishing by reason of prior use thereof".[63] A "mark" is defined in terms of Section 2 of the Trade Marks Act as "any sign capable of being represented graphically, including a device, name, signature, word, letter, numeral, shape, configuration, pattern, ornamentation, colour or container for goods or any combination of the aforementioned".[64]

The possibility for trade marks in sport include, *inter alia*, individual sport stars' names, catch phrases, nicknames and for the purpose of this dissertation also their image rights.[65] For a sport star to be able to register his image right, such right must be distinguishable from other sport stars' image rights. In using the example of Lionel Messi's name, the star did indeed apply to have his name "MESSI" registered as a trade mark during August 2011 at the European Union Intellectual Property Office ("EUIPO").[66] In August of the same year a Mr. Coma filed an opposition against the registration of his trade mark stating that there would be a confusion caused between the trade mark and the cycling brand "MASSI".[67] In 2013, the EUIPO Opposition Division upheld the opposition.[68] This was the beginning of Messi's long battle to have

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60 T Ahmad & S.R. Swain 'Celebrity Rights: Protection under IP Laws' (2011) 16 *Journal of Intellectual Property Rights* 10 and S.A van Zijl (2016) The Taxation of Image Rights in South Africa, unpublished LLM dissertation, University of the Free State 9.

61 T Ahmad & S.R. Swain 'Celebrity Rights: Protection under IP Laws' (2011) 16 *Journal of Intellectual Property Rights* 10 and S.A van Zijl (2016) The Taxation of Image Rights in South Africa, unpublished LLM dissertation, University of the Free State 9.

62 O Dean *et al Introduction to Intellectual Property Law* (2014) 93.

63 Section 9(1) and (2) of the Trade Marks Act 194 of 1993.

64 Section 2 of the Trade Marks Act 194 of 1993.

65 V Stilwell 'Can a Person's Image be Registered as a Trade Mark? The South African Perspective' published on 25 August 2016 https://www.polity.org.za/article/can-a-persons-image-be-registered-as-a-trade-mark-the-south-african-perspective-2016-08-25 (Accessed on 16 August 2020).

66 M Mancinella 'The visual, the phonetic and the famous: trademark similarity in the wake of Messi v EUIPO' (2018) 40(1) *European Intellectual Property Review* 1.

67 M Mancinella 'The visual, the phonetic and the famous: trademark similarity in the wake of Messi v EUIPO' (2018) 40(1) *European Intellectual Property Review* 1.

68 M Mancinella 'The visual, the phonetic and the famous: trademark similarity in the wake of Messi v EUIPO' (2018) 40(1) *European Intellectual Property Review* 2.

his name registered as a trade mark in Europe which ended before the General Court of the EU.[69] Messi's proposed trade mark composed of both word elements (his name "MESSI") and figurative elements (a stylised "M" above the surname).[70] The court had the task of assessing the likelihood of confusion between the two trade marks "MESSI" and "MASSI". The court had to consider the overall impression that these marks produce, taking into account their distinctive and dominant elements.[71] The General Court found that Messi is a public figure who is well known to most people who watch TV and listen to the radio.[72] The court held that anyone can identify (or can easily obtain confirmation from generally available sources) that the surname "MESSI" is the surname of the famous football player and public figure.[73] The General court concluded that the EUIPO First Board of Appeal, when finding that there would be confusion between the two trade marks, erred in not taking into account Messi's reputation.[74] The court found that Messi is famous enough that he will be recognised by the general public and that his fame is a conceptual criterion that will prevent the general public from confusing the two trade marks "MASSI" and "MESSI".[75]

The decision by the General Court was appealed by both EUIPO and Massi. The Court of Justice on 17 September 2020[76] upheld the General Court's decision stating that "the reputation of the person applying for his name to be registered as a trade mark is one of the relevant factors for the purposes of assessing the likelihood of confusion".[77] This decision shows how the fame of a sport star can be a significant factor when assessing the likelihood of confusion between registered trade marks.[78] Lionel Messi can now finally register his trade mark in Europe after a nine-year legal battle.[79] Lionel

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69 Messi Cuccittini v EUIPO (T-554/14) EU:T:2018:230; [2018] 4 WLUK 470 (GC).

70 M Mancinella 'The visual, the phonetic and the famous: trademark similarity in the wake of Messi v EUIPO' (2018) 40(1) *European Intellectual Property Review* 2.

71 M Mancinella 'The visual, the phonetic and the famous: trademark similarity in the wake of Messi v EUIPO' (2018) 40(1) *European Intellectual Property Review* 2.

72 Messi Cuccittini v EUIPO (T-554/14) EU:T:2018:230; [2018] 4 WLUK 470 (GC) para 52.

73 Messi Cuccittini v EUIPO (T-554/14) EU:T:2018:230; [2018] 4 WLUK 470 (GC) para 61.

74 Messi Cuccittini v EUIPO (T-554/14) EU:T:2018:230; [2018] 4 WLUK 470 (GC) para 63.

75 Messi Cuccittini v EUIPO (T-554/14) EU:T:2018:230; [2018] 4 WLUK 470 (GC).

76 Judgement in Joined Cases C-449/18 P EUIPO v Messi Cuccittini and C-474/18 P J.M. – E.V. e hijos v Messi Cuccittini.

77 Court of Justice of the European Union Press Release No 108/20, Luxembourg, 17 September 2020.

78 M Mancinella 'The visual, the phonetic and the famous: trademark similarity in the wake of Messi v EUIPO' (2018) 40(1) *European Intellectual Property Review* 2.

79 M Sugue 'Lionel Messi wins 9-year trademark battle with EU top court ruling' published on 17 September 2020 on Politico https://www.politico.eu/article/lionel-messi-finally-wins-eu-trademark-battle/ (Accessed on 24 October 2020).

Messi is joining the growing list of sport stars such as Cristiano Ronaldo and Usain Bolt, who have also registered their names as trade marks.[80] An example of a South African sport star registering his name as a trade mark is former springbok player Naas Botha.[81]

2.2 Sports Law

The best known and most recognised definition for image rights in the context of sports law in South Africa, as already quoted in Chapter 1, is the following:[82]

> "The ability of an individual to exclusively control the commercial use of his name, physical/pictorial image, reputation, identity, voice, personality, signature, initials or nickname in advertisements, marketing and all other forms of media… the sportsperson… often earns a substantial license fee or royalty that is paid for the privilege of allowing his name to be used for promotional purposes".

When examining image rights of sport stars there appears to be a lack of case law in South Africa. Globally, the first formal recognition of the said right is usually traced back to the United States of America 1953 case of *Haelan Laboratories, Inc v Topps Chewing Gum, Inc*[83] wherein Judge Jerome Frank first coined the term "right of publicity". The facts of the case was that Bowman Gum Company, the producer of baseball cards packaged with their bubble gum, sued Topps Chewing Gum for allegedly infringing upon the exclusive contract that the first producer had secured to exploit the commercial value of the likeness of Major League baseball players. [84] Prior to the *Haelan* case the boundaries of an individual's publicity rights were unclear.[85] What was established was that an individual had a right to privacy which protected

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80 Lexoligy 'Lionel Messi finally registers his name as a trade mark following long legal battle' by PM Cooper https://www.lexology.com/library/detail.aspx?g=23638806-354d-4d22-962f-d6310a25a0e5 accessed on 20 August 2020).

81 S Bosse 'Protecting the Image Rights of our Sport Stars' (2008) https://www.bosse-associates.co.za/protecting-the-image-rights-of-our-sport-stars/ (Accessed on 16 April 2018).

82 R Cloete *Introduction to Sports Law in South Africa* (2005) 176.

83 *Haelan Laboratories, Inc v Topps Chewing Gum, Inc* 202 F 2d 866 (2d Cir (1953)).

84 J Hylton 'Baseball Cards and the Birth of the Right of Publicity: The Curious Case of Haelan Laboratories v Topps Chewing Gum (2001) 273 *Marquette Law Scholarly Commons* 273.

85 J Hylton 'Baseball Cards and the Birth of the Right of Publicity: The Curious Case of Haelan Laboratories v Topps Chewing Gum (2001) 273 *Marquette Law Scholarly Commons* 273.

him from the unauthorised use of his name or images for commercial purposes.[86] However, this was limited to the right to protection of privacy and was not considered to be a "property right".[87] In the *Haelan case* the Judge moved beyond the mere protection of privacy and found that individuals (in this case Major League baseball players) also possessed a property right in their own images.[88] The court further held that this right could be transferred to a third party and that such party would also be able to enforce this right against the unauthorised use by a third party.[89] The court held that the commercial value of this right of control over his image lies in its exclusivity, i.e. for a person to be able to acquire the value of his image, he must be able to confer exclusive licenses to a third party to use his image. These licenses are protected to the exclusion of others on a legal basis.[90]

The practice of the commercial exploitation of a sport star's image rights is a relatively new development in South Africa and is not yet recognized as in other jurisdictions.[91]

Since the abovementioned court case, the concept of image rights expanded with time, as sports clubs became more reliant on commercial income. The Real Madrid Football Club president, Florentino Perez, recognised the value of player image rights and instituted a system where image rights of a player would be shared equally between the club and player.[92] The rationale behind introducing this system was that the commercial value of a player would be profoundly influenced by the fact that he

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86 J Hylton 'Baseball Cards and the Birth of the Right of Publicity: The Curious Case of Haelan Laboratories v Topps Chewing Gum (2001) 273 *Marquette Law Scholarly Commons* 273.

87 J Hylton 'Baseball Cards and the Birth of the Right of Publicity: The Curious Case of Haelan Laboratories v Topps Chewing Gum (2001) 273 *Marquette Law Scholarly Commons* 273.

88 J Hylton 'Baseball Cards and the Birth of the Right of Publicity: The Curious Case of Haelan Laboratories v Topps Chewing Gum (2001) 273 *Marquette Law Scholarly Commons* 274.

89 J Hylton 'Baseball Cards and the Birth of the Right of Publicity: The Curious Case of Haelan Laboratories v Topps Chewing Gum (2001) 273 *Marquette Law Scholarly Commons* 274.

90 M Louw 'Suggestions for the Protection of Star Athletes and Other Famous Persons against Unauthorised Celebrity Merchandising in South African Law' (2007) 19 S *AFR. Mercantile L.J* 275.

91 M Louw 'Suggestions for the Protection of Star Athletes and Other Famous Persons against Unauthorised Celebrity Merchandising in South African Law' (2007) 19 S *AFR. Mercantile L.J* 282.

92 Sportskeeda 'How are player image rights managed in football?' By N Srivastava 23 October 2015 https://www.sportskeeda.com/football/how-player-image-rights-managed-football/2 (Accessed on 18 May 2019 and 23 August 2020).

plays for Real Madrid.[93] This is because there exists a symbiotic relationship between the club and player. On the one hand the club builds their repertoire by having famous players. By exploiting their image rights and attracting large sponsorship deals with entities seeking association with the club because they have famous sport stars.[94] On the other hand, it has been found that football players who play for big and famous clubs are more popular which increases their image rights' value.[95] As a result of the club assistance in increasing the sport star's value of his image rights, it is generally agreed that the club is entitled to take a portion of the profits arising from the star's image rights.[96]

Image rights will typically be contained in a section of the more famous sport star's employment contract with his relevant club or franchise (or in an ancillary commercial agreement thereto) which will contain binding provisions stipulating the licensing or assignment of the image rights of the sports star.[97] This is usually a detailed section of the commercial contract which will include supporting provisions to facilitate the exploitation of such rights by the relevant rights holder.[98] These commercial contracts will therefore stipulate whether the sports star's image rights have an independent commercial value or whether the star consented thereto that his image may be exploited by the club or franchise where they are currently employed.[99] It follows naturally that this process is often subjected to negotiations between the club or franchise and the star or the star's manager. It is possible for the star to negotiate a

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93 Sportskeeda 'How are player image rights managed in football?' By N Srivastava 23 October 2015 https://www.sportskeeda.com/football/how-player-image-rights-managed-football/2 (Accessed on 18 May 2019 and 23 August 2020).

94 A Sierra 'Juventus strike new sponsorship deal thanks to Cristiano' posted on 13 February 2020 https://en.as.com/en/2020/02/13/football/1581584493_640286.html (Accessed on 23 August 2020).

95 Y He 'Predicting Market Value of Soccer Players Using Linear Modeling Techniques' in Technical Report, University of California, Berkeley, 2015.

96 Sportskeeda 'How are player image rights managed in football?' By N Srivastava 23 October 2015 https://www.sportskeeda.com/football/how-player-image-rights-managed-football/2 (Accessed on 18 May 2019 and 23 August 2020).

97 B Strydom & V Sinton 'Image Rights It's Time for Clarity and Certainty' (2013) 43 *TAXtalk* 42.

98 M Louw 'Suggestions for the Protection of Star Athletes and Other Famous Persons against Unauthorised Celebrity Merchandising in South African Law' (2007) 19 S *AFR. Mercantile L.J* 280 read together with R Cloete 'The Taxation of Image Rights: A Comparative Analysis' (2012) 45 *De Jure* 558.

99 Law in Sport 'Image rights and international footballers: the curious case of Mohamed Salah and the Egypt Football Association' by J Cohen published on 9 April 2019 https://www.lawinsport.com/topics/item/image-rights-and-international-footballers-the-curious-case-of-mohamed-salah-and-the-egypt-football-association (Accessed on 23 August 2020).

more favourable percentage ownership of his image rights or that these rights may even be excluded, thus providing the star with more power in respect of their own image rights' exploitation. This is generally the case with more famous sports stars, who understandably have more bargaining power to negotiate such a right.[100] This was evident when Real Madrid departed from their standard 50-50 per cent agreement for the first time with their contract with Cristiano Ronaldo when he signed a six-year deal with Real Madrid in 2009. Ronaldo was able to negotiate a 60-40 per cent arrangement whereby Ronaldo had exclusive rights to 60 per cent of his image rights and the Club only had 40%.[101] It has also been reported that the World Rugby Player of the Year and South African Springbok flanker Pieter-Steph du Toit has re-negotiated the image rights clause in his contract with Western-Province Rugby Union.[102] In terms of an agreement concluded in 2015, the image rights of all South African professional rugby players are held by the South African Rugby Union ("SARU").[103] This means that SARU, together with fourteen provincial unions, is entitled to exploit the collective images of all its contracted players for marketing and sponsorship purpose.[104] However, since the star's global exposure during the Rugby World Cup in 2019, his image rights value has increased exponentially and prompted him to revise this clause. The star managed to unbundle his image rights from that of the other players and now has exclusive control thereof which enables him to conclude lucrative deals with third parties for the exploitation thereof.[105] It is reported that the Springbok Captain Siya Kolisi also has exclusive control over his image rights.[106]

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100 Law in Sport 'Image rights and international footballers: the curious case of Mohamed Salah and the Egypt Football Association' by J Cohen published on 9 April 2019 https://www.lawinsport.com/topics/item/image-rights-and-international-footballers-the-curious-case-of-mohamed-salah-and-the-egypt-football-association (Accessed on 23 August 2020).

101 Sportskeeda 'How are player image rights managed in football?' By N Srivastava 23 October 2015 https://www.sportskeeda.com/football/how-player-image-rights-managed-football/2 (Accessed on 18 May 2019 and 23 August 2020).

102 Sport24 'Daily shot of Express-o – MyTwoCents' published on 18 May 2020 https://www.news24.com/sport/OtherSport/daily-shot-of-express-o-mytwocents-20200518-24 (Accessed on 25 October 2020) and City Press S Xabanisa 'Pieter-Steph's conundrum to break ranks with pay cuts' published on 17 May 2020 https://www.news24.com/citypress/Sport/pieter-stephs-conundrum-to-break-ranks-with-pay-cuts-20200516 (Accessed on 25 October 2020).

103 J Gous 'Image Rights might have kept Springbok star in South Africa' posted on 5 June 2020 https://www.swart.law/post.aspx?id=69 (Accessed on 25 October 2020).

104 J Gous 'Image Rights might have kept Springbok star in South Africa' posted on 5 June 2020 https://www.swart.law/post.aspx?id=69 (Accessed on 25 October 2020).

105 J Gous 'Image Rights might have kept Springbok star in South Africa' posted on 5 June 2020 https://www.swart.law/post.aspx?id=69 (Accessed on 25 October 2020).

106 J Gous 'Image Rights might have kept Springbok star in South Africa' posted on 5 June 2020 https://www.swart.law/post.aspx?id=69 (Accessed on 25 October 2020).

As illustrated above, the right to control and exploit a sports star's image rights may differ from star to star. However, it is accepted that the majority of sports industry executives found in favour of sport stars to have control over their image rights and the exploitation thereof.[107] For purposes of this dissertation the sport star himself is considered to be the only true owner of his image rights which grants him the freedom to register a trade mark in terms of the Trade Marks Act over, for example, his nickname.

In the modern-day digital environment where a vast portion of the world population have access to sport broadcasting platforms such as SuperSport and social media platforms such as Instagram, many sport stars have become household names and cultural icons. Most of the leading commercial brands are spending large amounts of money in the form of sponsorships and endorsements to associate their brands with the image of the sport star. The commercialization of a sport star's image rights is based on a reciprocal relationship where the advertiser enhances the reputation of their brand[108] by associating the product or goods with the sports star, and in return the sports star receives compensation from the advertiser for the use and exploitation of his image rights.[109]

There are different sources of income for a sport star in the exploitation of his image rights which include, *inter alia,* sponsorships, merchandising (or licensing) and endorsements.[110] Sponsorships are a successful and common vehicle for vendors to

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107 55% of sport executives voted that the sport star themselves should have control over their image rights. Those who considered the rights as belonging to 'all interested parties' amounted to 21.6%, whilst 16,5% were of the opinion that the club or team that the sports persons represent should control them. Only 3,7% were in favour of the national sports governing body holding the rights; and as little as 3.4% thought that the league in which the sports person plays should have control. See 'Looking After their Image' in the July 2003 issues of 'Sport Business International' Magazine, page 7 www.sportbusiness.com. This was an international poll and did not focus on South Africa specifically.

108 A study found that sport celebrity endorsement cue had a significant impact on a particular brand's uniqueness and esteem. For more on this see N van Heerden *et al* 'Investigating sport celebrity endorsement and sport event sponsorship as promotional cues' (2008) 147 *South African Journal for Research in Sport, Physical Education and Recreation*.

109 S Bosse 'Protecting the Image Rights of our Sport Stars' (2008) https://www.bosse-associates.co.za/protecting-the-image-rights-of-our-sport-stars/ (Accessed on 16 April 2018).

110 M Louw 'Suggestions for the Protection of Star Athletes and Other Famous Persons against Unauthorised Celebrity Merchandising in South African Law' (2007) 19 S *AFR. Mercantile L.J* 278.

advertise their brands by sponsoring a sporting event and thereby associating with the event in particular or by sponsoring a specific sports club. An example of a sports sponsorship is the insurance company brand Allianz that sponsors Juventus Football Club, the club for which Ronaldo plays. Juventus announced in February 2020 that the insurance company has extended their sponsorship agreement until 2030 wherein the club will receive 103.1 million Euros (approximately R2 billion) over the next ten years. [111] This deal means that the insurance company sponsors the club itself, and not individual players, and that their company brand will feature on the first team's training kit and on the back of the women's team kit.[112] It must be considered that sponsoring a football club does not automatically equate to the sponsorship of individual football players at the club. However, the Club will have more revenue available to pay the star a large sum of money under his playing contract, and the star will therefore still benefit from these types of sponsorships, perhaps only as part of their remuneration from the club. Ronaldo's lifetime deal with Nike takes a different form as it is an endorsement deal.[113] As part of Ronaldo's image rights negotiations over the years, he will always earn 100% of his existing deals with individual endorsements such as Nike.[114] This endorsement deal is said to be valued in the region of USD 1 billion (approximately R16.9 billion),[115] and differs from a sponsorship as the brand establishes a direct relationship with the sport star. This is based on the notion that the fans of the sports star desire the products that the star owns and uses.[116] Social media is at the centre of modern endorsement deals and the more the star's Instagram followers are engaged in the content that the star posts, the more

111 A Sierra 'Juventus strike new sponsorship deal thanks to Cristiano' posted on 13 February 2020 https://en.as.com/en/2020/02/13/football/1581584493_640286.html (Accessed on 23 August 2020).

112 A Sierra 'Juventus strike new sponsorship deal thanks to Cristiano' posted on 13 February 2020 https://en.as.com/en/2020/02/13/football/1581584493_640286.html (Accessed on 23 August 2020).

113 Tadem 'Sponsorship vs Endorsement deals' posted on 24 January 2019 https://tandempartnerships.com/sponsorship-endorsement/ (Accessed on 23 August 2020).

114 The Guardian 'Real Madrid unfazed by row over Cristiano Ronaldo's image rights' by S Lowe published on 17 June 2009 https://www.theguardian.com/football/2009/jun/17/cristiano-ronaldo-real-madrid-image-rights-row (Accessed on 23 November 2020).

115 A de Crespingy on Manofmany '6 largest athlete endorsement deals in the modern era' posted on 2 March 2020 https://manofmany.com/entertainment/sport/athlete-endorsement-deals (Accessed on 23 August 2020).

116 Tadem 'Sponsorship vs Endorsement deals' posted on 24 January 2019 https://tandempartnerships.com/sponsorship-endorsement/ (Accessed on 23 August 2020).

valuable such endorsement becomes.[117] Ronaldo is the sports star with the most Instagram followers in the world which enables him to attract such big endorsements.[118] The aforementioned is an illustration of how a sports star's image rights are exploited in the world of sport. This applies to local sport stars alike, with the famous South African cricketer AB de Villiers having endorsements such as Montblanc, Puma, Audi and the India-based tyre manufacturing giant MRF said to be valued in total in the region of $500 000 (Approximately R8.5 million).[119]

2.3 Image Rights Companies

In Chapter 3 the tax implication of income derived by a sport star from the exploitation of his image rights will be discussed in two scenarios. The first is where the star himself has exclusive control over his image rights, and the second is where the star enters into an agreement whereby he assigns his image rights to a company. These companies are known as "image rights companies" (hereafter "IRC").

A good example of how sport was commercialised is the Football Association Premier League, which was formed in 1992. Top footballers from around the world moved to England to play in the Premier League. As these players moved to the United Kingdom, the standard of football improved as did the global appeal for the game.[120] Pete Hackleton explains that this brings us to the position set out above where sport stars start to earn millions "as the value of high-profile talent employed by the clubs went far beyond the registration rights that attach to their on-field ability. Consequently, the use of image-rights contracts became increasingly popular. Such agreements allowed clubs to separate the payment of players for playing football under their employment agreements from payments to a player's image rights company for the use of the player's image. The image rights payments are not treated as salary but

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117 B Enoch 'How Athletes Get Endorsements and Sponsorships' posted on 9 March 2020 https://opendorse.com/blog/how-athletes-get-endorsements-and-sponsorships/ (Accessed on 23 August 2020).

118 A Sierra 'Juventus strike new sponsorship deal thanks to Cristiano' posted on 13 February 2020 https://en.as.com/en/2020/02/13/football/1581584493_640286.html (Accessed on 23 August 2020). As at 25 October 2020 Cristiano Ronaldo have 241 million Instagram followers.

119 Sportekz 'The 20 Highest Paid Cricket Players in the World 2020' posted on 6 June 2020 https://www.sportekz.com/list/highest-paid-cricketers-2020/ (Accessed on 23 August 2020).

120 Law in Sport 'The current legal status of image rights companies in football' by P Hackleton 5 July 2016 https://www.lawinsport.com/topics/articles/item/the-current-legal-status-of-image-rights-companies-in-football (Accessed on 7 May 2019).

payments to the company for services provided, thus reducing income tax for the player and National Insurance for both the player and the club."[121]

To establish an IRC, it must be evident that the sport star has an image that has an independent value to sponsors and endorsers.[122] If the image has a value which the player or manager desires to secure in a separate entity and separately manage the rights, the image should be valued and the rights formally transferred/assigned to a company.[123]

Once the company is established and the rights transferred, any future transfer to another club will require an agreement between the player or manager personally for their playing performance and duties to be negotiated. [124] In addition, if the club, or any other third party, plans to exploit the star's image rights for commercial activities over and above the basic rights granted in terms of the players' contract, the club will need to separately negotiate a deal with the image rights company.[125] There is therefore an evident distinction between a player's employment contract with a club, and a subsequent contract for the exploitation of the sports stars' image rights. An employment contract will stipulate terms for the sports star's remuneration from a club or franchise. The subsequent image rights contract will contain all relevant provisions for the exploitation of the star's image rights which will be paid directly by the club to the IRC – after which the sports star will receive the money indirectly by, for example, receiving a dividend.[126]

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121 Law in Sport 'The current legal status of image rights companies in football' by P Hackleton 5 July 2016 https://www.lawinsport.com/topics/articles/item/the-current-legal-status-of-image-rights-companies-in-football (Accessed on 7 May 2019).

122 Law in Sport 'The current legal status of image rights companies in football' by P Hackleton 5 July 2016 https://www.lawinsport.com/topics/articles/item/the-current-legal-status-of-image-rights-companies-in-football (Accessed on 7 May 2019).

123 Law in Sport 'The current legal status of image rights companies in football' by P Hackleton 5 July 2016 https://www.lawinsport.com/topics/articles/item/the-current-legal-status-of-image-rights-companies-in-football (Accessed on 7 May 2019).

124 Law in Sport 'The current legal status of image rights companies in football' by P Hackleton 5 July 2016 https://www.lawinsport.com/topics/articles/item/the-current-legal-status-of-image-rights-companies-in-football (Accessed on 7 May 2019).

125 Law in Sport 'The current legal status of image rights companies in football' by P Hackleton 5 July 2016 https://www.lawinsport.com/topics/articles/item/the-current-legal-status-of-image-rights-companies-in-football (Accessed on 7 May 2019).

126 Law in Sport 'The current legal status of image rights companies in football' by P Hackleton 5 July 2016 https://www.lawinsport.com/topics/articles/item/the-current-legal-status-of-image-rights-companies-in-football (Accessed on 7 May 2019).

Figure 1 depicts a basic IRC structure in a 4-step illustration:

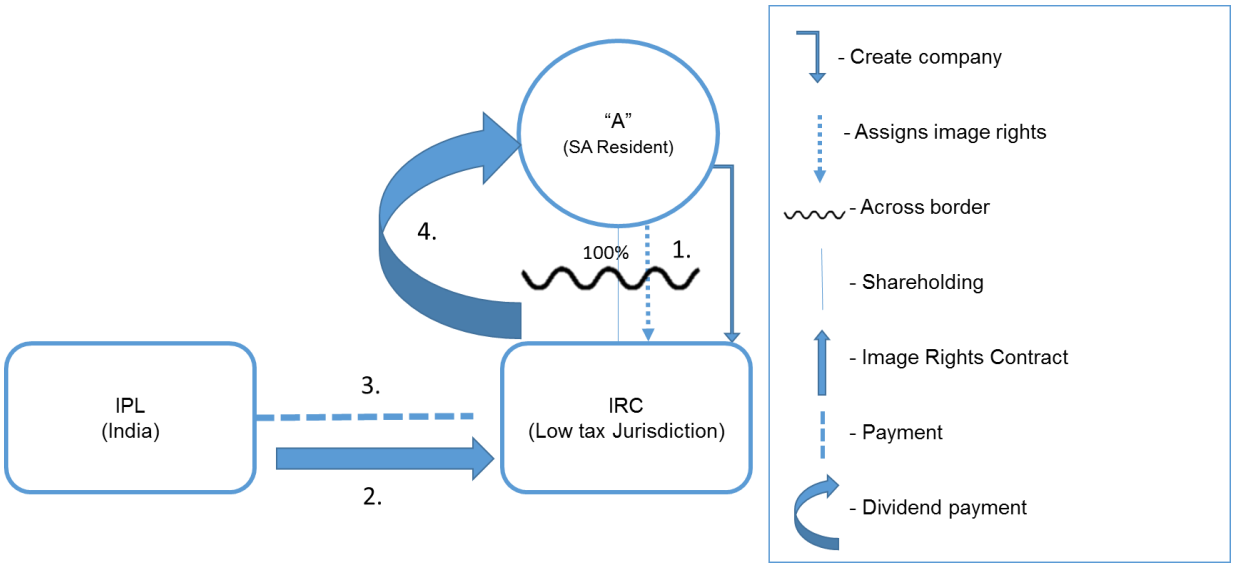

Figure 1 - Basic IRC Structure

1. A sport star, for example South African sport star "A", has a significant value to sponsors and he elects to create an IRC which is registered in a tax haven or low tax jurisdiction. He assigns his image rights to the IRC. A will hold the majority shares in the IRC.
2. The Indian Premier League (IPL) enters into an image rights contract with the IRC for the exploitation of A's image rights. The League do not hold any shares in the IRC.
3. The IRC receives monies from the League for the exploitation of A's image rights.
4. The monies received by the IRC flows back to A indirectly in the form of a foreign dividend.

The above diagram is an example of a very simplistic IRC structure. In practice the structure is much more complex in order to create a "wall" between the star and his image rights income, as can be seen in Lionel Messi's structure in Chapter 4 which is also illustrated with a diagram.

2.4 Conclusion

There is currently no recognition of any specific proprietary interest or property rights in the likeness of the *persona* of sport stars in South Africa.[127] It can therefore be concluded that the current South African laws does not recognise image rights. A sport star's name cannot be protected under the Copyright Act as this would prevent anyone from reproducing or broadcasting the star's name without his prior authorisation, which would be impractical.

Image rights can and has in the past been registered as a trade mark. The registration of image rights will have a dual function for a sport star: Firstly, the star indicates to third parties, such as sport clothing brands, that he is open to have his image rights exploited by such brands, because his image rights are registered as a trade mark. This is the commercial function of registering his image rights. The second function of registering his image rights as a trade mark is to obtain better legal protection against the unauthorised exploitation of these rights.

In the modern-day digital environment the fame of sport stars have grown exponentially, leading to commercial brands spending large amounts of money in the form of sponsorships and endorsements to associate their brand with the image of the sport star. This led to the commercialization of sport stars' image rights and ultimately created a new source of income for stars. A sport star can earn money through *inter alia* sponsorships, merchandising or licensing, and endorsements. Image rights are therefore most likely contained in a clause of the star's employment contract with the club for which he plays (or in an ancillary contract thereto). This is usually an extensive clause stipulating who has control over the star's image rights and, if applicable, to what percentage. It has become common practice for the star to separate the income from his employment contract from the income derived from his image rights. His image rights are therefore a second source of income for the star.

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127 S Bosse 'Protecting the Image Rights of our Sport Stars' (2008) https://www.bosse-associates.co.za/protecting-the-image-rights-of-our-sport-stars/ (Accessed on 16 April 2018).

This new source of income can be significant[128] and the global trend sees stars entering into tax minimisation schemes in attempt to lower their tax liability by shifting the income derived from their image rights to an offshore company. This offshore company is commonly known as an IRC.[129] The setup of the structure of an IRC can be explained in four steps:

1. The star assigns his image rights to the IRC (incorporated in a low tax jurisdiction), in which he holds the majority shares.
2. Third parties enter into image rights contracts with the IRC for the exploitation of the star's image rights.
3. The third parties pay the IRC directly for the exploitation of the star's image rights.
4. The IRC declares and pays the star a foreign dividends.

In Chapter 3 the tax implications of this second source of income, i.e. image rights, will be examined in two scenarios: Firstly where the star derives income directly from the third party for the exploitation of his image rights and the secondly, where the star creates an IRC and receives the income from the exploitation of his image rights indirectly from the IRC.

128 For example the famous cricketer South African sport star "A" is said to have endorsements worth R8.5 million as discussed in paragraph 1.2 above.

129 Image Rights Company.

Chapter 3: Application of South African Legislation on a South African Sport Star and a Foreign Image Rights Company

3.1 Introduction

In Chapter 2 image rights were generally discussed in the context of intellectual property law as well as sports law. In this Chapter South African tax legislation and the application thereof to image rights will be considered in two illustrative examples: The first is a South African sport star that receives monies directly for the exploitation of his image rights (Scenario One), and the second scenario is where the same sport star formally transfers or assigns his rights to an IRC[130] and then receives money indirectly for the exploitation of these rights (Scenario Two).

Both these schemes will also be tested against existing General Anti Avoidance Rules as well as specific anti avoidance rules contained in South African tax legislation, such as Controlled Foreign Companies regulations, to determine whether such schemes give rise to permissible or impermissible tax avoidance, or whether it could be deemed to be tax evasion.

3.2 General Tax Principles in South Africa

3.2.1 Tax Residency of Individuals

South African residents are taxed on a residence-based system and non-residents are taxed on a source-based system.[131] This means that taxes are levied on residents based on their worldwide income, and non-residents are only taxed on income sourced in South Africa.[132] The rationale behind this is that both South African residents and non-residents utilise South African resources to earn income and should contribute to the creation and maintenance of such resources in proportion to their South African sources of income.[133] To determine whether a natural person is a resident in South Africa, the person must be “ordinarily resident” in South Africa or must meet the requirements of the physical presence test.[134]

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130 As defined in Chapter 2, IRC stands for Image Rights Companies.
131 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 28.
132 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 28.
133 B Croome (Ed) *Tax Law: An Introduction* (2013) 20.
134 Paragraph (a)(i) and (a)(ii) of the definition of “resident” in section 1 of the Income Tax Act 58 of 1962.

The physical presence test is provided for in terms of Section 1 paragraph (a)(ii) of the Income Tax Act. It stipulates that a person will be resident even though he is not ordinarily resident if that person is physically present in South Africa for a period or periods:

> "(aa) exceeding 91 days in aggregate during the current year of assessment and 91 days in aggregation during each five years of assessment preceding the current year of assessment and;
> (bb) for a period exceeding 915 days in aggregate during the five years of assessment preceding the current year of assessment."

For example, it is common practice for a sport star to participate in a tournaments or leagues that require prolonged visits to other countries. If the sport star is not ordinarily a resident of South Africa, the physical presence test will be applied to determine if the star is a tax resident of South Africa. The first step is therefore to determine whether the star is an ordinary resident of South Africa. This term is not defined in the Act and one can therefore rely on case law.[135] In *Cohen v Commissioner for Inland Revenue*[136] the court had to consider on appeal whether the appellant, who lived and worked in New York for a period of 20 months, was considered as being "ordinary resident" in South Africa. The court established three important principles in determining the ordinary residence of a natural person.[137] Firstly, a person's ordinary residence would be the country to which that person would "naturally and as a matter of course return from his wanderings".[138] Secondly, the court further found that one should not only examine the facts of the year of assessment, but the taxpayer's "regular mode of life during periods outside the tax year may be taken into consideration".[139] Lastly, the court held that physical absence during the whole year of assessment was not decisive on its own and a person can still be ordinarily resident in South Africa even though he was not present during that year of assessment.[140]

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135 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 29.
136 *Cohen v Commissioner for Inland Revenue* 13 SATC 362.
137 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 29.
138 Page 371 *Cohen v Commissioner for Inland* 13 SATC 362.
139 Page 367 *Cohen v Commissioner for Inland* 13 SATC 362.
140 Page 363 *Cohen v Commissioner for Inland* 13 SATC 362.

SARS Interpretation Note 3 (Issue 2)[141] also expanded on the test for ordinarily resident and provides that it is the place where a natural person has his usual or principal residence that can be described as his real home. There is a list of factors that can be considered to determine whether a person is ordinarily resident in South Africa such as the intention to be ordinarily resident and the place of employment of the person. This list is not exhaustive and is merely used as a guideline.[142]

Once established a natural person is a resident for tax purposes they are required in terms of Section 22 of the Tax Administration Act[143] to register for tax purposes with the South African Revenue Service (SARS). They are required to submit annual tax returns in terms of Section 25 of the Tax Administration Act.[144]

3.2.2 Tax Residency of Companies

The definition prescribed to the term "company" as contained in Section 1 of the Income Tax Act is much wider than the definition contained in the Companies Act[145] and includes entities that are not considered companies in terms of the Companies Act. [146] It includes a variety of entities incorporated, or, deemed to be incorporated

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141 SARS *Interpretation Note 3 (Issue 2) "Resident: Definition in Relation to a Natural Person – Ordinarily Resident* (2018) https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-03%20-%20Resident%20definition%20natural%20person%20ordinarily%20resident.pdf (Accessed on 13 October 2019).

142 See SARS *Interpretation Note 3 (Issue 2) "Resident: Definition in Relation to a Natural Person – Ordinarily Resident* (2018) https://www.sars.gov.za/AllDocs/LegalDoclib/Notes/LAPD-IntR-IN-2012-03%20 %20Resident%20definition%20natural%20person%20ordinarily%20resident.pdf (Accessed on 13 October 2019) for the full list.

143 Tax Administration Act 28 of 2011.

144 Tax Administration Act 28 of 2011.

145 Companies Act 71 of 2008.

146 Section 1 of the Income Tax Act 58 of 1962 defines a company as:
"any association, corporation or company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or anybody corporate formed or established or deemed to be formed or established by or under any such law: or any association, corporation or company incorporated under the law of any country other than the Republic or anybody corporate formed or established under such law; or any co-operative; or any association (not being an association referred to in paragraph (a) or (f) formed in the Republic to serve a specified purpose, beneficial to the public or a section of the public; or any portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public (as defined in section 1 of the Collective Investment Schemes Control Act) are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interests; or portfolio of a collective investment scheme in property that qualifies as a REIT as defined in the listing requirements of an exchange approved in consultation with the Minister and published by the Prudential Authority, as defined in section

under any law within the Republic, and also include companies incorporated under the law of any country other than the Republic.[147] Any of the aforementioned entities or juristic persons can enter into the scheme discussed in this dissertation, however for the purposes of this study only companies will be considered. A "foreign company" is defined in Section 1 of the Income Tax Act as any company which is not a resident.

A company will be a "resident" of the Republic if it was incorporated in the Republic or if its place of effective management is within the Republic.[148] There is no definition in the Income Tax Act for either "incorporated" or "effective place of management".[149] A company can be incorporated in South Africa by one or more persons by completing and signing a Memorandum of Incorporation and by filing a Notice of Incorporation and paying a prescribed fee.[150] Once these provisions of the Companies Act has been complied with, one can accept that the company will be a resident by virtue of its incorporation within the Republic.[151]

It is possible for a company to be incorporated in one jurisdiction whilst it has its place of effective management in another jurisdiction.[152] Such a company will then be considered as a dual resident company.[153] The Organisation for Economic Co-operation and Development (known as the "OECD") stated that the "place of effective management" should be adopted as the preference criterion to apply when

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1 of the Financial Markets Act, in terms of section 11 of that Act; or a close corporation, but does not include a foreign partnership".
Section 1 of the Companies Act 71 of 2008 defines a company as "a juristic person incorporated in terms of this Act, or a juristic person that, immediately before the effective date was registered in terms of the Companies Act, 1973 (Act No. 61 of 1973), other than as an external company as defined in that Act; or Close Corporations Act, 1984 (Act No. 61 of 1984), if it has subsequently been converted in terms of Schedule 2; was in existence and recognised as an "existing company" in terms of the Companies Act, 1973 (Act No. 61 of 1973); or was deregistered in terms of the Companies Act, 1973 (Act No. 61 of 1973), and has subsequently been re-registered in terms of this Act. Also see M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 692.

147 Section 1 of the Income Tax Act 58 of 1962.

148 Part (b) of the definition of a resident in Section 1 of the Income Tax Act 58 of 1962.

149 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 33.

150 Section 13 of the Companies Act 71 of 2008.

151 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 33.

152 AW Oguttu "Resolving double taxation: the concept 'place of effective management' analysed from a South African perspective" (2008) 44 *Comparative and International Law Journal of South Africa* 82.

153 "Resolving double taxation: the concept 'place of effective management' analysed from a South African perspective" (2008) 44 *Comparative and International Law Journal of South Africa* 82.

153 Commentary on

determining the residence of such company.[154] There is no definition of "place of effective management" in Article 4(3) of the OECD Model Tax Convention. As a guidance, the OECD sets out three dominant factors[155] that should be taken into account when determining where the place of effective management is, being: "where key management and commercial decisions that are necessary for the conduct of its business as a whole are in *substance* made";[156] "where the most senior person, or group of persons, makes its decisions; and where the actions to be taken by the entity as a whole are determined".[157] To determine this, all facts and circumstances relevant to the particular company must be examined.[158] Because there is no definition for "place of effective management" local jurisdictions have adopted their own factors to determine what this would entail in their domestic law. In South Africa, SARS published an Interpretation Note[159] wherein it confirmed that South Africa will follow these general principles that the OECD adopted to determine the place of effective management. If the company is a resident in both South Africa and another country with whom South Africa has a tax treaty, the Double Tax Agreement will also give guidance as to what the "place of effective management" will entail.[160]

It is reiterated that this dissertation will focus on an IRC that is incorporated in a foreign jurisdiction. However, for a foreign IRC not to be regarded as being resident in South Africa, the effective management of the company also has to be in a foreign jurisdiction. The star will have to ensure that the place where the key management

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154 Article 4(3) of the OECD Model Tax Convention read together with Commentary on the OECD Model Tax on Income and on Capital (Full version) as read on 15 July 2014 at paragraph 3 of Article 4 page C (4)-8.

155 Paragraph 24 of the OECD Commentary read together with AW Oguttu "Resolving double taxation: the concept 'place of effective management' analysed from a South African perspective" (2008) 44 *Comparative and International Law Journal of South Africa* 83.

156 Commentary on the OECD Model Tax on Income and on Capital (Full version) as read on 15 July 2014 at paragraph 3 of Article 4 page C (4)-8.

157 AW Oguttu 'Resolving double taxation: the concept 'place of effective management' analysed from a South African perspective' (2008) 44 *Comparative and International Law Journal of South Africa* 83.

158 Commentary on the OECD Model Tax on Income and on Capital (Full version) as read on 15 July 2014 at paragraph 3 of Article 4 page C (4)-8.

159 SARS 'Resident – Place of effective management (companies) Interpretation Note no 6' (Issue 2) (2015).

160 I du Plessis 'The interpretation of double taxation agreements: a comparative evaluation of recent South African case law' (2016) 3 *TSAR* 484.

and commercial decisions necessary for the conduct of its business as a whole are made *in substance* in the jurisdiction[161] where the IRC is incorporated. Practically, this would mean, *inter alia*, that all board meetings are held at the foreign jurisdiction. The principle of "place of effective management" is based on traditional business models and fails to take into account the modern day manner in which the internet plays an intricate roll in the day to day business of a company.[162] It is for example possible for the directors of the IRC to have all their board meetings via an online platform whilst the top management reside in various jurisdictions. The OECD has also noted that the digitalisation and new business models of companies may render the current international tax rules such as the "place of effective management" outdated.[163] To address this, the OECD/G20 Inclusive Framework has been developing a Two-Pillar approach.[164] Pillar one will establish new "nexus-rules" and a fundamentally new way of sharing taxing rights between countries. This will then ensure that digitally-intensive companies pay taxes where they conduct sustained and significant business, even when they do not have a physical presence.[165] Pillar two will introduce a global minimum tax to help countries around the world to address remaining issues linked to Base Erosion and Profit Shifting.[166] Considering the current rules that are in place, (and not yet amended) it will be advisable for the sport star to travel to the jurisdiction where the IRC is incorporated to participate in the board meetings in that jurisdiction and rather avoid utilising online platforms such as *Zoom* and *Skype* to participate in these meetings, from South Africa.

If a company is accepted to be a resident company, it will be liable for tax in South Africa on its worldwide receipts.[167] As a company is a legal person and not a natural

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161 Commentary on the OECD Model Tax on Income and on Capital (Full version) as read on 15 July 2014 at paragraph 3 of Article 4 page C (4)-8.

162 T Gutuza 'Tax and e-commerce: where is the source' (201) 127 *South African Law Journal* 328.

163 OECD Tax Challenge arising from digitalisation: Top 10 Frequently asked Questions https://www.oecd.org/tax/beps/top-10-frequently-asked-questions-tax-challenges-digitalisation.pdf (Accessed on 13 April 2021).

164 OECD Tax Challenge arising from digitalisation: Top 10 Frequently asked Questions https://www.oecd.org/tax/beps/top-10-frequently-asked-questions-tax-challenges-digitalisation.pdf (Accessed on 13 April 2021).

165 OECD Tax Challenge arising from digitalisation: Top 10 Frequently asked Questions https://www.oecd.org/tax/beps/top-10-frequently-asked-questions-tax-challenges-digitalisation.pdf (Accessed on 13 April 2021).

166 OECD Tax Challenge arising from digitalisation: Top 10 Frequently asked Questions https://www.oecd.org/tax/beps/top-10-frequently-asked-questions-tax-challenges-digitalisation.pdf (Accessed on 13 April 2021).

167 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 33.

person, it will be taxed separately from the natural persons who hold the shares of the company.[168] All income (not of a capital nature) that a company receive will form part of its gross income.[169] A company is then liable for income tax on taxable income.[170] When there is a surplus in the company, the company can distribute a dividend to its shareholders.[171] The shareholders will then be liable to pay tax on the dividend that it received, which is collected by the company as a withholding tax on behalf of the shareholder.[172]

Similar to a natural person, a company is liable for tax on all its taxable income for a year of assessment. This is calculated in the same manner as income tax for a natural person in that the gross income is the starting amount from which exemptions and deductions are subtracted. The deductions available to a company differ from those available to natural persons and can be found throughout the Income Tax Act.[173] The corporate tax rate for taxable income of a company is 28% for the 2020/2021 year of assessment.[174]

3.3 Calculating a Taxpayer's Gross Income

3.3.1 Gross Income

The example that will be used in Scenario One is where a South African sport star, South African sport star "A", owns all of his own image rights. He furthermore elected to register his image rights as a trade mark in terms of the Trade Marks Act.[175] He then enters into a contract with a company, Montblanc South Africa and agree that his image rights may be exploited by Montblanc in exchange for payment for the use of his image. The below legislation will apply to the star, by virtue of him being a South African tax resident.

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168 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 692.
169 Definition of "gross income" in Section 1 of the Income Tax Act 58 of 1962.
170 Section 5(d) of the Income Tax Act 58 of 1962.
171 Section 4 of the Companies Act 71 of 2008 and definition of "Distribution" in terms of Section 1 of the Income Tax Act 58 of 1962.
172 Section 64G (1) of the Income Tax Act 58 of 1962.
173 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 693.
174 As published on 26 February 2020 on SARS "Companies, trusts and small business corporations (SBC)" https://www.sars.gov.za/Tax-Rates/Income-Tax/Pages/Companies-Trusts-and-Small-Business-Corporations.aspx (Accessed on 29 August 2020).
175 Trade Marks Act 194 of 1993.

"Gross income" as defined in Section 1 of the Income Tax Act in the case of a resident, is the total amount received by or accrued to such resident (includes cash or otherwise) and in the case of any person other than a resident, the total amount received by, or accrued to, or in favour of such person from a source within the Republic. This amount excludes receipts or accruals of a capital nature. The word "income" is defined in Section 1 of the Income Tax Act[176] as "the amount remaining of the gross income of any person for any year or period of assessment after deducting any amounts exempt from normal tax under Part I of Chapter II".

For individuals, the tax amount and percentage are progressive, i.e. the higher the taxable amount, the higher the percentage of tax levied.[177] This can be referred to as a "progressive rate structure".[178] The statutory rates for tax for the 2019/2020 year of assessment as published by SARS indicated that the highest rate of tax for amounts exceeding R1 500 000 (one million five hundred thousand rand) is R532 041 (five hundred thirty two thousand forty one rand) plus 45% of the amount by which taxable income exceeds R1 500 000 (one million five hundred thousand rand).[179] This maximum tax rate is the tax rate that will be applied to the relevant sport star in the relevant illustrative example.

The formula for the calculation of tax payable, can broadly be illustrated as follow:

Taxable Income

= Gross Income - Deductions - Exemptions + Taxable Capital Gains

Tax Payable = (Taxable Income × Tax Rate)-Rebates

3.3.2 Capital versus Revenue nature of the receipt

As seen from the above definition of "gross income", income that is of a capital nature is specifically excluded from the definition. It is therefore important to establish whether a receipt is revenue or capital in nature, as it will impact the tax treatment thereof.[180]

176 Income Tax Act 58 of 1962.
177 SARS Guide on Income Tax and the Individual (2019/20).
178 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 21.
179 SARS Guide on Income Tax and the Individual (2019/20) 15.
180 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 47 and 578.

Receipts and accruals of a capital nature may be subject to income tax by the inclusion of a taxable capital gain to form part of an individual's taxable income.[181]

"Capital gains tax" was introduced in South Africa in 2001 and is contained in the Eighth Schedule to the Income Tax Act.[182] This schedule applies to the disposal of assets of a resident and certain assets of non-residents.[183] A capital gain is an amount arising from the disposal of a capital asset that is equal to the amount by which the proceeds received or accrued in respect of that disposal exceeds the base cost (amount incurred in acquiring, producing or establishing the asset) [184] of that asset.[185] Such a capital gain does not form part of a taxpayer's gross income, but is included in a taxpayer's taxable income. These amounts are calculated separately and included in taxable income at varying inclusion rates depending on the nature of the taxpayer. For a natural person the inclusion rate is 40%.[186] A capital loss is triggered where the amount arising from the disposal of a capital asset (i.e. the proceeds) is less than the base cost of that asset.[187]

The Income Tax Act does not provide a definition for the term "capital" which causes a big debate around the question of whether a receipt or accrual should be regarded as either capital or revenue in nature.[188] When answering this question there is much reliance on case law.

One of the most used tests applied by the courts was established in *CIR v Visser*[189] which is to look at the nature of the transaction and the intention of the taxpayer.[190] In this case the taxpayer acquired mining options on specified farm properties. These options lapsed before the taxpayer could utilise them, however the taxpayer believed that he could acquire these options again as he had persuasive influence over the

181 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 47.
182 B Croome (Ed) *Tax Law: An Introduction* (2013) 334-335.
183 Paragraph 2 of the Eight Schedule of the Income Tax Act 58 of 1962.
184 B Croome (Ed) *Tax Law: An Introduction* (2013) 22.
185 Paragraph 3 of the Eight Schedule of the Income Tax Act 58 of 1962.
186 Paragraph 10(1)(a) of the Eight Schedule of the Income Tax Act 58 of 1962.
187 Paragraph 4 of the Eight Schedule of the Income Tax Act 58 of 1962.
188 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 47 read together with *Fourie Beleggings v CSARS* (168/08) [2009] ZASCA 37.
189 *CIR v Visser* (1937 TPD).
190 *CIR v Visser* (1937 TPD) read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 48.

farmers in the area.[191] The taxpayer subsequently entered into a contract with another person whereby the taxpayer would assist the other person in obtaining these lapsed mining options in exchange for shares in the other person's company.[192] The question before court was whether the shares that the taxpayer received were of a capital nature.[193] The following principles was established by the court: the taxpayer's intention when he entered into a contract will be of utmost importance to determine whether the money received or accrued is of a capital or revenue nature.[194] The court should not only have regard to what the taxpayer says his intention was, but the court should draw inference from the facts of the case to establish what his intention was at the time.[195] The court then referred to what is known as the "fruit versus tree" analogy.[196] The court held that:[197]

> ""Income" is what "capital" produces, or is something in the nature of interest or fruit as opposed to principal or tree. This economic distinction is a useful guide in matters of income tax, but its application is very often a matter of great difficulty."

The tree therefore represents capital and the fruit that a taxpayer makes from the tree is considered to be revenue in nature.[198] Although the taxpayer acquires the asset in order to produce income from it (i.e. capital asset), it cannot automatically be accepted that once the taxpayer disposes of such asset it will always be of a capital nature.[199] Authority for this can be found in the *Natal Estates Ltd v SIR*[200] case. The court found that something more is required than the mere decision to sell an asset that was originally held as a capital asset:[201]

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191 *CIR v Visser* (1937 TPD) read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 49.

192 *CIR v Visser* (1937 TPD) read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 49.

193 *CIR v Visser* (1937 TPD) read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 49.

194 *CIR v Visser* (1937 TPD) read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 49.

195 *CIR v Visser* (1937 TPD) read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 49.

196 L Olivier "Capital Versus Revenue: Some Guidance" (2012) 172 *De Jure* 173.

197 *Visser v CIR* SATC 271 para 276.

198 L Olivier "Capital Versus Revenue: Some Guidance" (2012) 172 *De Jure* 173.

199 L Olivier 'Capital Versus Revenue: Some Guidance' (2012) 172 *De Jure* 176.

200 *Natal Estates Ltd v SIR* 1975 4 SA 177 (A).

201 *Natal Estates Ltd v SIR* 1975 4 SA 177 (A) para 202 to 203.

> "From the totality of the facts one has to enquire whether it can be said that the owner had crossed the Rubicon and gone over to a business, or embarked upon a scheme, of selling such land for profit, using such land as his stock-in-trade"

As seen above, case law has established a number of principles to apply in the answering of this question. However, it must be noted that the courts have not yet devised a definite test that can be applied to all scenarios.[202] These various principles will therefore have to be applied to the facts of each case.

3.3.3 A detailed discussion of ITC 1735 64 SATC 455

In 2001, a South African court had the opportunity to assess whether monies received for the use of a sports star's name, likeness and biographical material (i.e. his image rights) where to be perceived as an "income" or a "capital receipt" for taxation purposes.[203] It should be noted that Tax Court judgments do not create a precedent. In ITC 1735[204], a UK resident and leading golf professional participated in the Nedbank Million Dollar Golf Challenge held at Sun City during December 1999. The Appellant had entered into an agreement with Sun International (South Africa) (Pty) Ltd in terms whereof the latter agreed to pay the golfer a royalty of US $100 000 for the right to:

> "exploit the golfer's intellectual property… including the utilisation of his likeness, biographical material, his presence at promotional events and media conferences and repeat television/video utilisation of his participation in the Tournament…"[205]

The Commissioner for SARS assessed the sum of US $100 000 paid to the golfer as income earned by him in South Africa during the assessment ending 28 February 2000.[206] The golfer objected to the assessment on the following grounds:[207]

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202 *Beleggings v CSARS* (168/08) [2009] ZASCA 37 para 7.
203 ITC 1735 64 SATC 455.
204 ITC 1735 64 SATC 455 (2001).
205 ITC 1735 64 SATC 455 para 3.
206 As discussed in paragraph 3.2.1.1 above, non-residents will be taxed in South Africa on their South African sourced income.
207 ITC 1735 64 SATC 455.

1. Capital vs. Income nature of the receipt

   The Appellant argued that the income received was a capital receipt and not part of his "gross income". This was inherent to the fact that the payment was not for services rendered, but was "purely fortuitous" and a by-product of his agreement to participate in the Tournament.[208]

2. Section 35 and Section 9 of the Income Tax Act

   At the time of the hearing, section 35 of the Income Tax Act, together with section 9(1)(b) of the same Act, was applicable to the matter.[209] Section 35 of the Income Tax Act provided that where a non-resident received an amount referred to in Section 9(1)(b) or (bA) of the Income Tax Act from a South African source, the non-resident is deemed to have derived taxable income that is equal to thirty percent (30%) of that amount received. The Appellant therefore argued that only 30% of the income received by the Appellant should have been subjected to tax.

3. Application of the UK / South African Double Tax Agreement

   The Appellant argued that should the court find that the receipt does form part of his gross income, such receipt was deemed to accrue to him in terms of the then applicable section 9(1)(b) of the Income Tax Act on the basis that his image rights qualified as "property or rights similar in nature" under section 9(1)(b)(i) of the Income Tax Act.[210] The payment was therefore a royalty payment and was not taxable in South Africa in terms of the then applicable Article 11 of the Double Tax Agreement between UK and South Africa, the consequence of which would be that he would be exempt from South African tax as he was subject to tax in the UK. [211]

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208 ITC 1735 64 SATC 458 para 10.

209 Both these sections has since been repealed.

210 ITC 1735 64 SATC 458 para 10

211 This double taxation agreement has since been replaced by a new agreement signed on 4 July 2002 which can be found at https://www.gov.uk/government/publications/south-africa-tax-treaties#:~:text=The%20double%20taxation%20agreement%20entered,April%202003%20for%20Corporation%20Tax (Accessed on 15 October 2020).

Goldblatt J heard the matter on appeal and held that:

1. Capital vs. Income nature of the receipt

   In terms of Section 82 of the Income Tax Act (as read at time of the hearing)[212] the onus of proof rests on the taxpayer; in this instance the Appellant (the golfer). The court considered his submissions as set out above and found that the monies derived from the use of his "image rights" were income in the ordinary sense of the word and cannot be considered to be capital of nature. The court held that the Appellant allowed his name and reputation to be used as publicity for the payment of US $100 000 and it cannot be said that it was purely fortuitous that the monies were paid to him.

   By allowing his name and reputation, which is seen as his image rights, to be used did not cause him to dispose of such "assets" as he continued to possess them after the tournament and after he received remuneration for the use thereof. The court ultimately held that there could be no doubt that the payment made was not of a capital nature and was the type of income that a professional golfer would expect to earn for participating in a golf tournament that traded on the reputation of the participants.[213] Accordingly, the court held that the monies received formed part of his "gross income" as defined in Section 1 of the Income Tax Act.[214] I agree with this finding.

2. Section 35 and Section 9 of the Income Tax Act

   Upon the submissions made by the golfer that if the monies form part of his gross income, it should be deemed to accrue to him in terms of section 9(1)(b) of the Act. The court found that he was paid money to allow his name, biographical details to be used and to allow interviews with him during the tournament. In terms of section 9(1)(b), patents, designs, trade marks and copyrights are all rights designed to protect the creators of original intellectual works. The court found that the golfer's name, likeness etc. are not a product of his own creative effort and are of an entirely different nature

212 This section has since been repealed and Section 102 of the Tax Administration Act 28 of 2011 places the burden of proof on the taxpayer.
213 ITC 1735 64 SATC 459 para 10.2.
214 ITC 1735 64 SATC 459 para 10.2.

to the rights listed in section 9(1)(b)(i).[215] The consequence of the image rights not forming part of section 9(1)(b)(i) was that section 35(1) also did not apply to the income received by the Appellant. The court found that the Commissioner of SARS therefore correctly disallowed the objection that the US $100 000 failed to be assessed in terms of section 35(1) of the Act as the receipt was part of his "gross income" and was received from a source within the Republic.[216]

It should be noted that both Sections 9(1) and 35 of the Income Tax Act has since been repealed and the taxation of royalties are now governed by section 49A-H of the Income Tax Act. Should the same facts be before court under these new provisions, it is not certain whether the court would arrive to the same conclusion.

3. Application of the UK / South African Double Tax Agreement

Article 11 of the UK/South Africa Double Tax Agreement that was applicable at the time read as follows:

> "(1) Royalties arising in a Contracting State and paid to a resident of the other Contracting State who is subject to tax there in respect thereof shall be exempt from tax in the first-mentioned Contracting State."

The term "royalties" as used in Article 11 means payments of any kind received as a consideration for the use of, or the right to use any copyright of literary, artistic or scientific work, any patent, trade mark, design or model, plan, secret formula or process etc. The court held that the monies received were not a royalty as defined in Article 11 of the Agreement since the use of the Appellant's name, likeness and biographical details are not creative effort by the golfer and are accordingly of an entire different nature to patents, designs or copyright.[217] The court considered a letter from the UK tax authorities stating that, for the purposes of the UK/South African Double Taxation Agreement, the income of a professional golfer derived from any

215 ITC 1735 64 SATC 459 para 11.
216 ITC 1735 64 SATC 459 para 11.
217 R Cloete 'The Taxation of Image Rights: A Comparative Analysis' 564.

personal activities exercised by him are not dealt with in terms of the agreement. Accordingly, the court found that there was no evidence that the golfer was subject to tax in the UK in terms of article 11 of the Double Tax Agreement in respect of that specific direct payment.[218]

It is reiterated that the Double Tax Agreement referred to in this case has since been replaced and should a similar scenario arrive before court, it is uncertain whether the court would arrive at the same conclusion.[219]

3.4 Dividends Tax

The sport star will hold shares in the IRC and will be entitled to a distribution of the profits held in the company. A "distribution" can be in the form of a dividend.[220] For the purpose of this dissertation it is accepted that the sport star will only receive a distribution from the IRC in the form of a dividend. There will also not be a discussion on contributed tax capital, but merely a general discussion on the laws applicable to dividends tax.

3.4.1 Receipt of a Local Dividend

A company can choose to make distributions to its shareholders in the form of a dividend payment. Section 1 of the Income Tax Act defines a dividend as any amount transferred or applied by a resident company for the benefit of a person who holds shares in that company, excluding an amount consisting of a distribution of an asset *in specie*. There is a distinction between a cash dividend and a dividend *in specie* mainly because a cash dividend can be withheld by the person responsible to pay the dividends tax amount to SARS, where this is not possible for a distribution of an asset

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218 ITC 1735 64 SATC 459 para12.

219 The term "royalties" has an identical definition under Article 12 of the new Double Tax Agreement between South Africa and the United Kingdom which can be accessed from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/526893/s-africa-dta.pdf. I am of the view, given that the wording DTA had remained the same, that if the matter was heard today, the court may arrive at the same conclusion as seen in ITC 1735 64 SATC 455

220 Definition of "distribution" in the Companies Act 71 of 2008 means "a direct or indirect transfer by a company of money or other property of the company, other than its own shares, to or for the benefit of one or more holders of any of the shares, or to the holder of a beneficial interest in any such shares, of that company or of another company within the same companies, whether in the form of a dividend …"

in specie.[221] This dissertation will only examine the provisions applicable to cash dividends.

The "beneficial owner" of a cash dividend is liable for the dividends tax in respect of that dividend.[222] A "beneficial owner" is defined as the person who is entitled to the benefit of the dividend attaching to a share in a company.[223] This will include a shareholder of a company. An obligation is placed on a withholding agent which includes the company that declares and pays a dividend to withhold an amount of dividend tax to be paid directly to SARS.[224] A withholding company may be relieved of this responsibility if it holds certain declarations and written undertakings from the beneficial owner of the dividend indicating that the beneficial owner qualifies for exemption from dividend tax in terms of section 64F of the Act.[225] For example, dividends paid to certain beneficial owners are exempted from dividends tax. Section 64F(1)(a) of the Income Tax Act specifies that dividends paid to a resident company is exempted from dividends tax. This is to prevent dividends tax from being levied more than once when there are more than one company to which the same profits are shared by way of dividend transfers and then eventually transferred to its ultimate shareholders.[226] Where the beneficial owner is for example an individual, there would be no exemption applicable. Should a dividend not be exempt, a dividend tax of 20% is levied to the amount of dividend paid when paid to a South African resident.[227] The dividend amount that was paid or accrued then forms part of the shareholder's gross income.[228]

When a dividend is paid to a foreign beneficial owner in a jurisdiction with which South Africa concluded a double tax agreement, the owner may be eligible for treaty relief in the form of a reduced dividend rate in respect of the dividends tax imposed by South Africa.[229]

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221 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 702.
222 Section 64EA (a) of the Income Tax Act 58 of 1962.
223 Section 64D of the Income Tax Act 58 of 1962.
224 Section 64G (1) of the Income Tax Act 58 of 1962.
225 Section 64G (2) of the Income Tax Act 58 of 1962.
226 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 707.
227 Section 64E of the Income Tax Act 58 of 1962.
228 Part (k) of the definition of gross income in Section 1 of the Income Tax Act 58 of 1962.
229 Section 64G (3) (a) of the Income Tax Act 58 of 1962 read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 711.

There are several exceptions to these exemptions. Specific anti-avoidance rules related to exempt dividends can be found in Section 64EB of the Income Tax Act. As seen from the example above, certain exemptions are based on the nature of the beneficial owner. This may create opportunities for taxpayers to enter into schemes and or structure their affairs in such a manner to ultimately avoid the dividends tax by transferring the right to a person in whose hands the dividends are exempted.[230] These anti-avoidance rules then apply to such schemes and deem the true beneficial owner (cedent) to be liable for dividend tax as opposed to the person to whom the beneficial ownership has been shifted (cessionary) prior to the dividend being paid. An example of such anti-avoidance rule is Section 64EB (1) of the Income Tax Act that applies when a person "acquires the right to a dividend in respect of a share by way of a cession and an amount in respect of that dividend is received by or accrued to the person who acquired that right. In this instance the person who ceded that right is deemed to be the beneficial owner of the dividend".[231] This subsection will not apply if the person to whom those rights are ceded will hold all the rights attaching to the share after the cession.[232]

3.4.2 Receipt of Foreign Dividends

As stated above, for tax purposes, a foreign company is a company that is not a tax resident in the Republic. This means that the company is not incorporated within the Republic and that its effective place of management is in a jurisdiction outside of South Africa.

For purposes of the illustrative examples, we can accept that the South African sport star will hold the majority of shares in the offshore IRC, which is a non-resident for tax purposes, and the sport star will be closely involved in the management of this IRC. .

The general definition of a "foreign dividend" in Section 1 of the Income Tax Act means "an amount that is paid by a foreign company in respect of a share in that specific

230 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 710.
231 Section 64EB (1) of the Income Tax Act 58 of 1962.
232 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 711.

foreign company".[233] This definition is applied throughout the Income Tax Act. The definition of a dividend in Section 64D of the Income Tax Act applies specifically to dividend tax and includes a dividend paid by a foreign company that is listed on the Johannesburg Stock Exchange (hereafter "JSE") and where such dividend is paid to a resident who does not qualify for an exemption and specifically excludes a distribution of an *asset in specie*.[234] Dividends declared by a foreign company not listed on the JSE are therefore not subject to dividends tax.

The definition of "gross income" for a South African resident does however include any amount received or accrued by way of a foreign dividend.[235] A foreign dividend received by a resident is exempt from his or her income tax if that person holds at least ten per cent of the total equity shares and voting rights in the company declaring the foreign dividend.[236] This is referred to as the participation exemption.[237] Therefore, where a South African tax resident sport star incorporates an IRC in a foreign jurisdiction and holds more than ten per cent of the total equity shares and voting rights in that IRC, the foreign dividends that they receive from the IRC may be exempted from his or her income tax in South Africa. The IRC will be subject to the tax laws of the country where it is incorporated or where its place of effective management is.

3.5 Royalties Withholding Tax

It has been determined in this study that image rights, even though not yet recognised as a standalone right under Intellectual Property laws in South Africa, can be registered as trade marks and therefore seen as the intellectual property of a sport star. The sports star transfers or assigns his image rights to an IRC. This dissertation assumes that the IRC created by the sport star will be incorporated in a jurisdiction outside of the Republic. For example, a South African sports brand who enters into a contract with the IRC to exploit the image rights of the sport star is therefore entering into a cross-border transaction. Such transactions are generally subject to withholding

233 Section 1 of the Income Tax Act 58 of 1962.
234 Section 64D of the Income Tax Act 58 of 1962 read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 722.
235 Part (k) of the definition of gross income in Section 1 of the Income Tax Act 58 of 1962.
236 Section 10B (2) (a) of the Income Tax Act 58 of 1962.
237 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 89.

taxes, in particular withholding tax on royalties which is governed by Sections 49A-H of the Income Tax Act.

As South Africa follows a residence-based tax system, the source of the income becomes relevant for a non-resident (referred to as a foreign person in section 49A-H of the Income Tax Act) when determining whether a transaction will be subject to tax in South Africa.[238] Section 9(1) of the Income Tax Act defines a "royalty" as "payments received or accrued in respect of the use, right to use, or permission to use any intellectual property as defined in Section 23I of the Income Tax Act".[239] The definition of "intellectual property" in terms of Section 23I of the Income Tax Act includes, *inter alia*, trade marks as defined in the Trade Marks Act.[240] For these purposes it is accepted that either the sport star in his own name or the IRC as the company holding the image rights will be able to register these image rights as trade marks, as discussed in Chapter 2. The cross-border transaction for the sports brand to obtain the right to use the sport star's image rights from the IRC in question will therefore be subject to withholding tax on royalties, but will be subject to the relevant Double Tax Agreement.

The purpose of withholding tax is usually to ensure that the tax is collected in circumstances where there is a non-resident that is not physically present in the country involved as it might otherwise be difficult to collect it.[241] South Africa imposes withholding tax on passive income such as royalty payments for the use of intellectual property that does not require the presence of the person in a country.[242] A withholding levy of 15% of the amount of any royalty that was paid by any person to any foreign person from a source within the Republic is levied.[243] These withholding taxes only apply to payments made to non-residents who do not have a strong presence in South Africa. This is due to the higher risk that taxes payable by such a non-resident are not collected. Where the non-resident has a stronger presence in South Africa, this risk is reduced.[244] In this instance, as the shareholder of the foreign company is the sport

238 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 798.
239 Section 9(1) of the Income Tax Act 58 of 1962.
240 Section 23I (1) (c) of the Income Tax Act 58 of 1962.
241 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 820.
242 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 820.
243 Section 49B(1)(a)(i) of the Income Tax Act 58 of 1962.
244 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 820.

star who is a South African resident, he will be subject to tax based on his residency in the Republic. To this end it must be considered that even though the sports star resides in South Africa, they will only receive dividends from the IRC. It is the IRC, which is incorporated in a foreign jurisdiction that will receive payment for the use of the image rights. The IRC itself therefore does not have a presence in South Africa.

The IRC will be liable for the royalty tax, however the responsibility to withhold the tax and pay the amount to SARS rests upon the person who makes the relevant payment to the non-resident i.e. the sporting brand company situated in South Africa who pays the royalty amount to the foreign person.[245] This person is referred to as the "withholding agent" and such agent will be held personally liable for the withholding amount.[246]

Cross-border transactions may pose a challenge for income tax purposes as they may attract tax in more than one jurisdiction.[247] This can happen where a person, irrespective of their residence, is taxed on the source-based system for income that was sourced in a country for the use of its resources (source country) and then again taxed based on the residence-based system as the recipient of the income is a resident in that country (country of residence).[248] If the recipient is subject to double taxation due to more than one country subjecting the same transaction to tax, such transaction will not be economically feasible.[249] In order to curb this, Governments entered into double tax agreements (referred to as "DTA").[250] These DTAs can also be referred to as tax treaties. These DTAs generally limit one of the countries involved from having the right to tax the cross-border transaction.[251] Once withholding royalty

245 Section 49B (1) of the Income Tax Act 58 of 1962.
246 Sections 156 and 157 of the Tax Administration Act 28 of 2011.
247 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 795.
248 L Olivier & M Honibal *International Tax A South African Perspective* (2011) 11 read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 796.
249 A W Oguttu 'A critique of international ta measures and the OECD BEPS Project in addressing fair treaty allocation of taxing rights between residence and source countries: the case of tax base eroding interest, royalties and service fees from an African perspective' (2018) 29 *Stellenbosch Law Review* 314 read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 796.
250 L Olivier & M Honibal *International Tax A South African Perspective* (2011) 6.
251 A W Oguttu 'A critique of international ta measures and the OECD BEPS Project in addressing fair treaty allocation of taxing rights between residence and source countries: the case of tax base eroding interest, royalties and service fees from an African perspective' (2018) 29 *Stellenbosch Law Review* 316 read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 796.

tax is present, any DTA or treaties entered into between the parties involved in such cross-border transaction must be considered. When it has been established that there is a tax treaty that was entered into between the Contracting State (which is the source country) and payment was made to the Other Contracting State (country of residence) the royalties paid are exclusively taxable in the country of residence if the OECD Model Tax Convention is followed.[252] The United Nations (hereafter "UN") Model Double Taxation Convention affords greater taxing rights to the source country[253] and Article 12 thereof states that these royalty payments may be taxed in both countries.[254] It is important to note that that the meaning of a "royalty" is different in various treaties. It may well be that the definition of a royalty in an applicable treaty will be defined in a manner other than how it is defined in Section 23I of the South African Income Tax Act.[255]

As an example, consider an IRC with residency in Mauritius[256] (as it is both incorporated in Mauritius and its effective place of management is in Mauritius) with whom a South African entity enters into an agreement to exploit a sport stars' image rights. By exploiting the image rights they are using intellectual property of a non-resident and royalty tax will therefore be applicable. As the IRC is a resident of Mauritius, it must be established whether a DTA was entered into between the two countries. There is a DTA in effect between South Africa and Mauritius[257] that specifies that withholding tax on royalties shall apply to this DTA.[258] The IRC will therefore qualify for relief on the royalties in terms of this DTA. Article 12 of the treaty specifically deals with royalties. Article 12(2) of the Mauritius/South Africa treaty provides the following relief:

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252 OECD Articles of the Model Convention with respect to Taxes on Income and on Capital (28 January 2003) Article 12 (1) 14.

253 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 810.

254 United Nations Double Taxation Convention between Developed and Developing Countries (2017) Article 12(1) and (2) 22.

255 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 811.

256 I consider Mauritius for this illustrative example, as this is a low tax jurisdiction with whom South Africa has a Double Tax Agreement.

257 Government Gazette No. 471 dated 17 June 2015 "Agreement between the Government of the Republic of South Africa and the Government of the Republic of Mauritius for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income" (hereafter "SA and Mauritius DTA") and J Marseglia 'I'll take what's behind door number two: Picking the right entity to minimise taxes in offshore transactions' (2010) 24 *TAXtalk* 34.

258 Article 2(3)(b)(iii) of SA and Mauritius DTA

> "However, such royalties may also be taxed in the Contracting State in which they arise, and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed 5 per cent of the gross amount of the royalties".

The definition of "royalties" in this treaty includes payments for the use of a trade mark i.e. image rights.[259] For the purpose of this DTA the "Contracting State" will be South Africa, as the entity who pays for the exploitation of the image rights is a resident.[260] The "Other Contracting State" will be where the IRC is a resident, i.e. Mauritius. As the IRC is the owner of the image rights it shall be deemed as the "beneficial owner" of the royalties. It will therefore qualify for the relief as set out above in Article 12(2) of the DTA. The practical application of this relief will see South Africa still able to impose withholding tax on the royalty payment, but to a reduced rate of 5% as opposed to the normal 15%.[261]

3.6 The Taxation of Professional Sports Clubs and Players in South Africa

3.6.1 SARS' Guide on the Taxation of Professional Sports Clubs and Players

On 27 May 2016 SARS issued a Draft Guide on the Taxation of Professional Sports Clubs and Players[262] which was changed from a draft guide to a final guide on 8 March 2018. SARS explained that the main purpose of the guide is to set out and explain the South African tax consequences for professional sports clubs and players in South Africa.[263]

It should be kept in mind that a published SARS guide is not to be construed as legislation nor is it an official publication as defined in Section 1 of the Tax

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259 Article 12(3) of SA and Mauritius DTA.

260 Article 12(5) of SA and Mauritius DTA.

261 An example was provided in M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 811 which was applied to this scenario.

262 SARS *Guide on the Taxation of Professional Sports Clubs and Players* (2018) https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-Gen-G08%20-%20Guide%20on%20the%20Taxation%20of%20Professional%20Sports%20Clubs%20and%20Players.pdf (Accessed on 10 September 2018).

263 SARS *Guide on the Taxation of Professional Sports Clubs and Players* (2018) 1 https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-Gen-G08%20-%20Guide%20on%20the%20Taxation%20of%20Professional%20Sports%20Clubs%20and%20Players.pdf (Accessed on 10 September 2018).

Administration Act.[264] In *SARS v Marshall NO*[265] the High Court and Supreme Court of Appeal was called upon to interpret provisions of the Value Added Tax Act 89 of 1991. The Supreme Court of Appeal regarded the SARS Interpretation Note 39 as persuasive explanations, although not binding on the courts or a taxpayer.[266] The taxpayer appealed the judgment to the highest court and the Constitutional Court gave a clear stance on the use of SARS interpretation notes in the interpretation of legislation:

> "Why should a unilateral practice of one part of the executive arm of government play a role in the determination of the reasonable meaning to be given to a statutory provision? It might conceivably be justified where the practice is evidence of an impartial application of a custom recognised by all concerned, but not where the practice is unilaterally established by one of the litigating parties. In those circumstances it is difficult to see what advantage evidence of the unilateral practice will have for the objective and independent interpretation by the courts of the meaning of legislation, in accordance with constitutionality compliant precepts. It is best avoided".[267]

It is now an established principle in law that courts shall not consider SARS interpretation notes when presiding over a litigious matter regarding the interpretation of tax legislation.[268]

Section 5 of the Tax Administration Act[269] refers to practice generally prevailing which is the manner in which SARS interprets legislation and how they generally approach tax matters in practice. This is once again not legislation which can be enforced on a taxpayer but more of a guideline as to how SARS approaches certain tax matters.

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264 Tax Administration Act 28 of 2011.

265 *Marshall and Others v Commissioner, South African Revenue Service* (2018) ZACC 11.

266 *Commissioner, South Africa Revenue Services v Marshall NO and Others* 2017 (1) SA 114 (SCA) para 33.

267 *Marshall and Others v Commissioner, South African Revenue Service* (2018) ZACC 11 para 10.

268 Cliffe Dekker Hofmeyer Attorneys 'Status of SARS Interpretation Notes' in *Tax & Exchange Control Alert* published on 4 May 2018 https://www.cliffedekkerhofmeyr.com/en/news/publications/2018/Tax/tax-alert-4-may-status-of-sars-interpretation-notes-.html (Accessed on 18 September 2020) 4.

269 Tax Administration Act 28 of 2011.

3.6.1.1 Inclusion of Image Rights in Gross Income

The SARS Guide on the Taxation of Professional Sports Clubs and Players refers specifically to image rights and describes its payments as "payments that a player receives from an enterprise that uses such player's image for advertising purposes".[270] When dealing with the taxation of such payments, the guide states that image rights cannot be "sold" to another person as these rights cannot be separated from the sportsperson.[271] This finding by SARS will be discussed in paragraph 3.6.2 hereunder where it will be illustrated why I disputes its correctness.

The Guide refers to the ITC 1735 64 SATC case (discussed above) and supports the finding of the court that payment received for the exploitation of a star's image rights will be deemed to be of a revenue nature and will form part of the star's gross income.

It is clear from this guide that SARS is of the view that capital gains tax will not apply to these payments and a star is merely allowed to exploit his image rights by, for example, using it in an advertisement. The Guide further makes it clear that SARS will view these payments received by sportspersons as income to be included in the star's gross income and therefore subject to income tax.[272] Although the Guide does not deem it possible to register image rights as a trade mark, it is submitted by the author of this dissertation that their aforementioned conclusion can be applied to a scenario where image rights are registered as a trade mark. The authority for this can be found in the Income Tax Act. The definition of gross income in Section 1 of the Income Tax act specifically includes certain amounts even if they are generally of a capital nature. In terms of the gross income definition, any amount which is received or accrued to a person as a premium, or considered in the nature of a premium for the use or right of

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270 SARS *Guide on the Taxation of Professional Sports Clubs and Players* (2018) 34 https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-Gen-G08%20%20Guide%20on%20the%20Taxation%20of%20Professional%20Sports%20Clubs%20and%20Players.pdf (Accessed on 10 September 2018).

271 SARS *Guide on the Taxation of Professional Sports Clubs and Players* (2018) 34 https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-Gen-G08%20%20Guide%20on%20the%20Taxation%20of%20Professional%20Sports%20Clubs%20and%20Players.pdf (Accessed on 10 September 2018).

272 SARS *Guide on the Taxation of Professional Sports Clubs and Players* (2018) 34 https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-Gen-G08%20%20Guide%20on%20the%20Taxation%20of%20Professional%20Sports%20Clubs%20and%20Players.pdf (Accessed on 10 September 2018).

use of any trade mark as defined in the Trade Mark Act, is specifically included in the taxpayer's gross income.[273] Therefore, should an entity exploit a sport star's image rights and pay the star premiums for such right, these premiums will form part of the star's gross income.

3.6.1.2 Remuneration versus Revenue nature of receipt

As stated in Chapter 2, image rights will most likely be contained in a section of the sport star's employment contract with the relevant club or franchise, kindly refer to Annexure A and Annexure B as examples in this regard.[274] This contract will stipulate whether the star's image rights have an independent commercial value or whether the star consented thereto that his image may be exploited by the club or franchise where they are currently employed. There are therefore two possible scenarios, one where the image rights forms part of the star's employment contract and one where it is separated from the sport star's employment contract.

In the Guide on the Taxation of Professional Sports Clubs and Players, SARS states that should a club make payments for the use of image rights by that club to whom the sportsperson is contracted, such payment will constitute "remuneration". It is assumed that SARS is here referring to the scenario where these rights specifically form part of the star's employment contract. SARS concludes that the club will be obliged to withhold employees" tax and the amount paid for the use of the star's image rights, which must be disclosed on the star's IRP5 form.[275] The definition of "remuneration" as provided for in the Fourth Schedule of the Income Tax Act includes any amount which is payable by way of any "salary, leave pay, wages, overtime pay, bonus, gratuity, commission, fee, emolument, pension, superannuation allowance, retiring allowance or stipend, whether in cash or other and whether or not in respect of

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273 Part (g)(iii) of the definition of "gross income" in Section 1 of the Income Tax Act 58 of 1962.

274 Annexed hereto are two agreements illustrating how image rights are set out in the South Africa cricket and rugby national teams' agreements. In the Cricket South Africa agreement (annexure "A"), the term "cricketer attributes" are used to define image rights. The clause dealing specifically with these terms are found in paragraph 3.2 of the contract. In the South African Rugby Employers' Organisation collective agreement (annexure "B"), the terms "player attributes" is used to define image rights. The clause dealing specifically with these terms are found in paragraph 42 of the contract.

275 SARS *Guide on the Taxation of Professional Sports Clubs and Players* (2018) 34 https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-Gen-G08%20%20Guide%20on%20the%20Taxation%20of%20Professional%20Sports%20Clubs%20and%20Players.pdf (Accessed on 10 September 2018).

services rendered" which includes any amount referred to in "paragraphs (a),(c), (cA), (d), (e) or (f) of the definition of "gross income" in Section 1 of the" Income Tax Act.[276]

This treatment could be challenged in circumstances where the sport star also registered his image rights as a trade mark, as payments for the use of this right may constitute a "royalty". Royalties will be discussed in detail below, but essentially translates to payments received or accrued in respect of the use, right to use, or permission to use any intellectual property.[277] Stiglingh *et al* submits that royalty payments do not fall within the definition of "remuneration" if they are received for the use of a trade mark.[278] This view is correct. The club would therefore not be obliged to deduct employees' tax from the royalty payment.[279] The royalty payment will be made directly to the sport star and it will form part of his gross income.[280]

In the instance where the sport star negotiated with the club that his image rights have an independent commercial value as opposed to forming part of his employment contract, the payments received for the use of these rights will form part of the star's gross income and the club will not be obliged to deduct employee's tax from such payment as it will not be regarded as "remuneration".

3.6.2 Assignment of Image Rights (Scenario Two)

As mentioned in the introduction section of this Chapter, there are two illustrative scenarios that will be discussed in this Chapter: one is where the star receives income directly from a third party as part of his gross income. The second scenario is where the star assigns his image rights to an IRC and indirectly earns dividends from the IRC. This assignment of the image rights to a foreign IRC will attract further legal and tax consequences. From the outset a distinction must be drawn between the meaning attached to "assignment" in the context of lawfully disposing of these rights (as contemplated in terms of Part XI of the Trade Marks Act and paragraph 11(a) of Schedule 8 of the Income Tax Act) from a scenario where one merely "cedes" or

276 Fourth Schedule Part I definition of remuneration.
277 Section 9(1) of the Income Tax Act 58 of 1962.
278 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 271.
279 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 271.
280 Paragraph (g)(iii) of the definition of "gross income" in Section 1 of the Income Tax Act 58 of 1962.

"donates" the right to receive income from such rights. For the purpose of this dissertation, it is accepted that the star disposes of his image rights and sells these rights at an arm's length to the IRC and the provisions of Section 7 of the Income Tax Act is therefore not applicable.

In the SARS Guide on the Taxation of Professional Sports Clubs and Players it was stated that image rights cannot be "sold" to another person as these rights cannot be separated from the sportsperson.[281] I am not in agreement with this statement.

Even though "image rights" are not yet recognised under any intellectual property legislation, the sport star has exclusive control over this right and it is submitted that such right can be separated from the sport star by way of registering his image rights as a trade mark. The reason for this, as discussed in Chapter 2, is that the sport star's name and image is so distinguishable from that of another, due to the fact that the star is so well known worldwide. This has been done in practice and various examples thereof is provided in Chapter 2. Consequently, as with any other trade mark, the star is able to assign this registrable trade mark to another person or entity as provided for in Section 39 of the Trade Marks Act. The transfer of the image rights will be completed by way of a written Deed of Assignment which the assignor of the trade mark (i.e. the sport star) will execute. The transfer of ownership will generally be recorded in the Register of Trade Marks. [282] The statement by SARS is therefore, in my view, ungrounded, as an image right can be registered as a trade mark in terms of the Trade Mark Act and such a trade mark can be sold or disposed of by the relevant parties.

Previously, there was a great deal of uncertainty that arose when ownership of a registered trade mark was assigned from a South African resident to a foreign company. Although the Trade Marks Act recognises such transfer in the same manner as though it was assigned between two residents, the Exchange Control Authorities

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281 SARS *Guide on the Taxation of Professional Sports Clubs and Players* (2018) 34 https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-Gen-G08%20%20Guide%20on%20the%20Taxation%20of%20Professional%20Sports%20Clubs%20and%20Players.pdf (Accessed on 10 September 2018).

282 O Dean "Keep the Trade Mark Assignment Baby When Throwing Out the Bathwater" (2004) 71 *Encyclopedia of Brands and Branding* 71.

had an interest in such assignments.[283] The main purpose of the Exchange Control Regulations is to "prevent the loss of foreign currency resources through the transfer abroad of real or financial capital assets held in South Africa".[284] One of the manners to achieve this, Regulation 10(1)(c) prohibits the conclusion of any transaction with a consequence of capital or any right to capital being either directly or indirectly exported from the Republic of South Africa without first obtaining the permission of the Treasury.[285] In *Oilwell (Pty) Ltd Protect International Limited*[286] (hereafter the *Oilwell* case) the Supreme Court of Appeal was called upon to determine whether an agreement to assign a trade mark by a South African company to a foreign company constituted an export of capital from South Africa, as envisaged by Regulation 10(1)(c) of the Exchange Control Regulations and would therefore require the permission of the SA Reserve Bank, being the agent of the Treasury, prior to such assignment.[287] The facts in this matter was briefly that the trade mark "Protec" is registered in various countries across the world. Oilwell approached the court for an order to reverse an assignment of the trade mark, including the foreign Protec marks and pending trade mark applications, which was assigned from a number of parties to Protec International Ltd, a company registered in Guernsey, in 1998.[288] Oilwell claimed that this original assignment was concluded without the requisite permission from Treasury and was therefore null and void.[289] In order for Regulation 10(1)(c) to apply to the assignment, there had to be an exporting of capital or right to capital. The question therefore is: When a South African company assigns a trade mark to a foreign company, does the South African company export capital, or a right in capital?[290] Before this can be answered, the court had to first determine the meaning of the word "capital" which is not defined in the Exchange Control Regulations.[291] The court elected not to define the word "capital" and confined itself to the question of whether

283 O Dean "Keep the Trade Mark Assignment Baby When Throwing Out the Bathwater" (2004) 71 *Encyclopedia of Brands and Branding* 72.

284 Exchange Control Manual published by the Reserve bank as a guideline to the Exchange Control Regulations available at *http://www.resbank.co.za* (Accessed on 20 September 2020).

285 Regulation 10(1)(c) of the Exchange Control Regulations

286 *Oilwell v Protec* (295/10) [2011] ZASCA 29.

287 *Oilwell* case para 6.

288 *Oilwell* case para 1.

289 *Oilwell* case para 4.

290 M du Preez and S Luiz "Going offshore: The assignment of a Trade Mark and the meaning of "Capital": Oilwell (Pty) Ltd v Protec International (Pty) Ltd (2012) 129 *SALJ* 32,

291 *Oilwell* case para 7.

trade marks are within this particular framework considered to be "capital".[292] The court held that the meaning of "capital" depends on the context in which it is used.[293] The term "capital" in the present context is used in a financial sense.[294] The court refer to the *Encarta World English Dictionary* which states the meaning of "capital" in a financial context is "cash for investment and money that can be used to produce further wealth".[295] The learned judge held that "serious anomalies would arise" should it be found that everything with monetary value would be "capital".[296] When referring specifically to trade marks the court held that, like all other intellectual property rights, they are "territorial and akin to immovables" and can therefore not be "exported".[297] The learned judge was ultimately of the view that a restrictive interpretation[298] was called for and found that the assignment of a trade mark to a foreign company does not amount to the exportation of capital.[299] The sport star will therefore not have to first obtain the permission from the Treasury when assigning his trade mark to an IRC that is registered offshore.

Capital gains tax will apply in this context to the scenario where the sport star assigns his image rights to the IRC after the IRC has been incorporated in a foreign jurisdiction. An overview of a capital receipt has already been provided in 3.2.2.2 above. For a capital gain or loss to arise, there must be four building blocks present, namely; an asset, the disposal of the asset during the year of assessment, the base cost of the asset, and the proceeds on the disposal of the asset.[300] Each of these will be applied to this scenario below.

Despite the above judgment,[301] "trade mark" is still included in the definition of an asset for capital gains tax purposes in the Eighth Schedule of the Income Tax Act.[302] Paragraph 1 of the Eighth Schedule of the Income Tax Act defines an "asset" as

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292 *Oilwell* case para 7.
293 *Oilwell* case para 8.
294 *Oilwell* case para 9.
295 *Oilwell* case para 8.
296 *Oilwell* case para 5.
297 *Oilwell* case para 13.
298 *Oilwell* case para 11.
299 *Oilwell* case para 15.
300 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 577.
301 *Oilwell v Protec* (295/10) [2011] ZASCA.
302 Edward Nathan Sonnenbers "Offshore assignment of intellectual property" (2011) 143 *SAICA.*

"property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum; and a right or interest of whatever nature to or in such property". This definition is broad enough to include intellectual property such as a trade mark.[303]

The sport star "assigns" his image rights as a trade mark to the IRC. Paragraph 11 of the Eight Schedule of the Income Tax Act defines a "disposal" broadly, which definition do not specifically include the word "assigns". It does however include "any other alienation or transfer of ownership of an asset".[304] When the star assigns the image rights the star effectively transfers ownership of his image rights to the IRC and therefore meets the definition of disposal in the Eighth Schedule.[305]

Paragraph 20 of the Eight Schedule of the Income Tax Act sets out that the "base cost" will entail all expenditure actually incurred by the star in relation to these "image rights" which will include *inter alia* the valuation of the image rights in order to determine whether there was a capital gain or loss.

The last building block is regulated under Paragraph 35 of the Eight Schedule of the Income Tax Act and deals with the proceeds from the disposal. Sections 39 and 40 of the Trade Marks Act does not specifically require that a purchase price or consideration should be paid by the assignee to the assignor for the trade mark to be legally assigned. It therefore frequently happens in attempts to circumvent capital gains tax that an assignment or a transfer of a registered trade mark takes place for a significant low value or even for no value at all.[306] This is usually when the assignee and assignor are "connected persons". "Connected persons" is defined in the Income Tax Act in relation to a company to mean any person who "holds, directly or indirectly, at least 20 per cent of the equity shares in the company or the voting rights in the company".[307] As the sport star and the IRC are clearly connected persons, paragraph

303 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 587 read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 582.

304 Paragraph 11(1)(a) of the Eight Schedule of the Income Tax Act.

305 Edward Nathan Sonnenbers "Offshore assignment of intellectual property" (2011) 143 *SAICA.*

306 O Dean "Keep the Trade Mark Assignment Baby When Throwing Out the Bathwater" (2004) 71 *Encyclopaedia of Brands and Branding* 71 – 72.

307 Paragraph (d)(iv) of the definition of connected persons in Section 1 of the Income Tax Act 58 of 1962.

38 of the Eight Schedule of the Income Tax Act will be applicable. This provides that where a person disposes of an asset to a person who is a connected person immediately prior to or immediately after that disposal in relation to that person for a consideration which does not reflect an arm's length price, the proceeds of such disposal are deemed to be the market value of that asset on the date of the disposal.[308] Therefore, the value will be deemed to be at market value in our scenario.

Once the star assigns his image rights to an IRC, this action meets the four buildings blocks applicable to capital gains tax and a capital gain or loss is triggered. It will have to be determined whether there was a capital gain or a capital loss and should there be a capital gain, the capital gains tax must form part of the sport star's income at an inclusion rate of 40% for the year of assessment that his image rights was disposed of. [309]

Another possible tax effect of the star assigning his image rights at a nominal value may be that the tax authorities deem such assignment as a donation.[310] Paragraph 11(1)(a) of the Eight Schedule of the Income Tax Act considers the donation of an asset as a disposal. When, in the opinion of the Commissioner such disposal took place for a consideration that is not adequate, the amount of the deemed donation will be the fair market value of the property less the consideration payable by the person (in our scenario IRC) acquiring it.[311] There is a general annual donation tax exemption of R100 000 of the sum of all property donated during that year of assessment available to a natural person.[312] The star will be subject to donation tax at 20% for the market value of his image rights less the amount paid therefore by the IRC less the general exemption amount of R100 000.[313]

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308 Paragraph 38(1)(a) of the Eight Schedule of the Income Tax Act 58 of 1962.
309 Paragraph 10(1)(a) of the Eight Schedule of the Income Tax Act 58 of 1962.
310 Section 58 of the Income Tax Act 58 of 1962 and Edward Nathan Sonnenbers "Offshore assignment of intellectual property" (2011) 143 *SAICA.*
311 Section 58 of the Income Tax Act 58 of 1962 and M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 946.
312 Section 56(2)(b) of the Income Tax Act 58 of 1962.
313 Edward Nathan Sonnenbers "Offshore assignment of intellectual property" (2011) 143 *SAICA.*

3.7 Tax Schemes involving an Image Rights Company

3.7.1 Introduction

Scenario one above discussed the tax implication for a sport star when monies for the exploitation of his image rights are received directly from the entity using the right. This part of the Chapter applies relevant legislation relating to the taxation of a foreign company to address scenario two where a sport star makes use of a company (an IRC) to house his image rights and to receive distributions from such company. An IRC is generally a company incorporated in an offshore (foreign) jurisdiction in which a sport star holds shares. In order to consider the potential tax benefit derived from this arrangement, this dissertation will examine the tax legislation applicable to such foreign company and the receipt of the distribution made by the IRC in the hands of the sport star.

3.7.2 Utilisation of IRC for Tax Planning Purposes

It has been stated by the author that the creation of an IRC is a minimisation scheme that the star enters into. The remainder of this Chapter will evaluate the validity of such scheme. Generally accepted as permissible tax avoidance, tax planning is the strategic arrangement of one's tax affairs to ensure you're a minimal tax liability.[314] Sport stars who earn millions through the exploitation of their image rights in addition to their already lucrative salaries will generally contract the assistance of a tax expert for professional tax planning to ensure beneficial structuring of their tax affairs.[315] The creation of an IRC in itself is the product of careful tax planning.

The first characteristic of such a scheme is the separation between remuneration received for the use of skills on the field of play, and the income received for the exploitation of his image rights off the field of play i.e. the separation of a sport star's image rights from his employment contract with the club or franchise.[316]

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314 SARS *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962* (2005) 4 https://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrepDP200501%20%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf (Accessed on 29 September 2019).

315 E Retief "Is it Possible to Avoid Tax Legally?: Tax Professional" (2011) 4 *Tax Professional* 34.

316 R Cloete "The Taxation of Image Rights: A Comparative Analysis" (2012) 45 *De Jure* 558. Blackshaw 566.

The effect of the creation of an IRC can be depicted through the use of three tables.[317] Firstly, a fairly ordinary arrangement of merely separating the income (Table A). Secondly, the creation of a resident IRC that is incorporated in South Africa (Table B) and then lastly the most aggressive scheme which is the creation of an offshore IRC that is registered in a "tax haven"[318] (Table C).

Table A : No Image Rights Company

Salary	**R**	**Image Rights**	**R**
Receipt	50 000	Receipt (it is accepted that there are no deductions applicable)	100 000
Less 45% tax[319]	(22 500)	Less 45% tax	(45 000)
Net Income	27 500	Net Income	55 000
Total Income = R82 500.00			

Table B: Image Rights Company registered in South Africa

Salary	**R**	**Image Rights received by way of a South African company**	**R**
Receipt	50 000	Receipt in the hands of the company (it is accepted that there are no deductions applicable)	100 000
Less 45% tax	(22 500)	Less 28% Company tax[320]	(28 000)

317 R Cloete "The Taxation of Image Rights: A Comparative Analysis" (2012) 45 *De Jure* 558. Blackshaw 566 created similar tables to illustrate the effect of the various arrangements.

318 The OECD defines a "tax haven" as a country which imposes low or no tax, and is used by corporations to avoid tax which otherwise would be payable in a high-tax country. According to OECD report, tax havens have the following key characteristics; No or only nominal taxes; Lack of effective exchange of information; Lack of transparency in the operation of the legislative, legal or administrative provisions. OECD Glossary of Tax Terms https://www.oecd.org/ctp/glossaryoftaxterms.htm (Accessed on 12 October 2019).

319 For the purpose of these illustrations we accept that the player is taxed on the highest rate of tax. For rates of tax for individuals visit https://www.sars.gov.za/Tax-Rates/Income-Tax/Pages/Rates%20of%20Tax%20for%20Individuals.aspx (Accessed on 12 October 2019).

320 For rates of company tax visit https://www.sars.gov.za/Tax-Rates/Income-Tax/Pages/Companies-Trusts-and-Small-Business-Corporations.aspx (Accessed on 12 October 2019).

Local Dividend received (subjected to dividend WHT at a rate of 20%) R72 000 x 80%	57 600	Income of the company after tax	72 000
		Dividend declaration from retained earnings: Amount paid to Sport star: 57 600 Dividend WHT withheld (20%) 14 400	(72 000)
Net Income	85 100	Net Income	nil
Total Income = R 85 100.00			

Table C: Offshore Image Rights Company registered in Cayman Islands

Salary	**R**	**Image Rights received by way of a foreign company**	**R**
Receipt	50 000	Receipt (it is accepted that there are no deductions applicable)	100 000
Foreign dividend received from IRC, included in gross income in terms of para (k) of gross income definition	100 000	Less 0% Corporate tax[321]	(0)
		Net Income	100 000
Less 45% tax (calculated only on 50 000 as the foreign	(22 500)	Declaration of a dividend: Amount paid to sport star: R100 000	(100 000)

321 The Cayman Islands are one of the most well-known tax havens in the world. They do not have a corporate tax. For more information on this visit *Why are the Cayman Islands considered a Tax Haven?* Written by C Boyte-White updated 30 July 2019 https://www.investopedia.com/ask/answers/100215/why-cayman-islands-considered-tax-haven.asp (Accessed on 12 October 2019).

dividend is exempt in terms of section 10B(2))		Dividend withholding tax levied: nil	
Net Income	127 500	Net Income	Nil
Total Income = R 127 500.00.			

It is clear that there is a significant difference between these various schemes. The last arrangement depicted in table C is the most likely to be challenged in court by revenue authorities as it clearly depicts a scenario where the star shifted a portion his income to an offshore jurisdiction, thereby paying a substantially lower amount of tax on income derived from the exploitation of his image rights.

3.7.3 Tax Avoidance vs. Tax Evasion

As outlined previously, the incorporation of an IRC to receive payments are a result of tax planning. The question this dissertation will strive to address is whether this scheme constitutes tax avoidance, tax evasion or simply tax "minimisation".

Firstly, a distinction is made between tax avoidance and tax evasion. In both instances there is a revenue loss for the *fiscus*.[322] However, the two concepts differ fundamentally in that tax avoidance is not inherently illegal whereas tax evasion is illegal and leaves the evader liable to punitive measures such as fines or imprisonment.[323] Wheatcroft gave a practical example of the distinction in that "the man with a new Swiss watch in his pocket who says to the Customs "I have nothing to declare" is evading tax and should be clearly distinguished from the man who keeps within the law and does not use fraud or concealment".[324]

Tax avoidance is the reduction of a taxpayer's tax liability using the provisions of the fiscal legislation to his advantage.[325] This is legal, despite being unpopular with the revenue authorities.[326] The courts have often supported the right of a taxpayer to avoid

322 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 1115.
323 BT Kujinga "A comparative analysis of the efficiency of the General Anti-Avoidance Rule as a Measure against Impermissible Income Tax Avoidance in South Africa", University of Pretoria, 2013 15.
324 GSA Wheatcroft "The Attitude of the legislature and the Courts to Tax Avoidance" (1955) 209 *The Modern Law Review* 209.
325 B Croome (Ed) *Tax Law: An Introduction* (2013) 487.
326 B Croome (Ed) *Tax Law: An Introduction* (2013) 487.

tax. The most often-quoted ruling confirming the permissibility of tax avoidance is from the United Kingdom case of *IRC v Duke of Westminster*[327] wherein the judge, Lord Tomlin stated "every man is entitled if he can to arrange his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure that result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax". In *Levene v IRC*[328] the court also held that a taxpayer is free to make their own arrangements so that their cases may fall outside the scope of the taxing Acts. Although legal, it often draws criticism because, when successful, it reduces the flow of tax revenues into the fiscus. In certain circumstances the avoidance schemes that are entered into can be so aggressive that it may verge on tax evasion, which renders such an arrangement or scheme illegal. It is therefore necessary for tax legislation to provide anti-avoidance provisions that can be used by the revenue authorities to counter tax avoidance.[329]

Tax evasion, in contrast to tax avoidance, is the reduction of a taxpayer's tax liability by illegal means. Simply put, it is when a taxpayer structures his affairs in such a manner that he commits fraud against the *fiscus*. The penalties available to SARS are set out in the Tax Administration Act.[330]

3.7.4 The South African General Anti Avoidance Rules

Tax avoidance can either be permissible tax avoidance or, when structured in a certain way, be regarded as impermissible tax avoidance. Sections 80A to 80L of the Income Tax Act make up the general anti-avoidance rule (known as "GAAR") which can be regarded to act as a "safety net" for arrangements not dealt with by specific anti-avoidance provisions.[331]

The application of GAAR can be divided into two steps:

327 *IRC v Duke of Westminster* (1936) AC1 (HL).
328 *Levene v IRC* (1928) AC 217 227.
329 B Croome (Ed) *Tax Law: An Introduction* (2013) 488.
330 Tax Administration Act 28 of 2011.
331 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 1117.

Step 1: Two requirements to be met[332]:

1. There must be an arrangement. Section 80L of the Income Tax Act defines an arrangement as "any transaction, operation, scheme, agreement or understanding, including all steps therein or parts thereof, and includes any of the foregoing involving the alienation of property". This mainly considers what the taxpayer did to obtain the tax benefit i.e. the action that is the cause of the tax benefit - for example, establishing an IRC to receive payments for the use of the image rights of the sport star.

2. There must be a tax benefit. The definition for a tax benefit specifically in terms of GAAR was deleted in 2010 by Section 77 of Act 7 of 2010. The general definition provided in Section 1 of the Income Tax Act include "any avoidance, postponement or reduction of any liability for tax". It is therefore clear that the benefit must be that the taxpayer is paying a lesser amount, or alternatively, no tax. In the example illustrated in Table C of section3.3, there will be a tax benefit in that the IRC will receive the royalty payments directly and pay minimal tax in the tax haven. The sport star will subsequently receive a dividend from the IRC on which he will pay a lesser amount of tax.

Once there is a tax benefit, the arrangement changes into an avoidance arrangement. A rebuttable presumption also exists that the avoidance arrangement when objectively determined, has the sole or main purpose to avoid tax.[333] For the party obtaining the tax benefit to rebut this presumption, it must be proven that the party "reasonably considered in light of the relevant facts and circumstances, obtaining a tax benefit was not the sole or main purpose of the avoidance arrangement".[334]

Step 2: A basis has now been established on which the permissibility or impermissibility of the avoidance arrangements can be examined. For the avoidance

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332 *X V Commissioner for the South African revenue service; y v Commissioner for the South African Revenue Service* (IT 24502; IT 24503) [2020] ZATC 16 (12 November 2020) para 61.

333 Section 80G of the Income Tax Act 58 of 1962.

334 Section 80G of the Income Tax Act 58 of 1962.

arrangement to constitute impermissible tax avoidance, Section 80A of the Income Tax Act stipulates that it must have one of the following tainted elements[335]:

1. Subsection (a)(i) and (ii) In the context of business:
    a. It must be abnormal for a *bona fide* business purpose.
    b. It must lack commercial substance, in whole or part, i.e. if the arrangement makes sense only by reference to its tax benefits, not to its economics or business potential.
2. Subsection (b) in the context other than business:
    a. It must be abnormal for a *bona fide* purpose.
3. Subsection (c)(i) and (ii) in any context:
    a. It must create rights and obligations that are not normally created by persons dealing at arm's length i.e. both parties must seek to obtain a benefit.
    b. It results directly or indirectly to a misuse or abuse of the provisions of the Act.

When applying the above to the example, it is clear that the IRC will be incorporated to merely negotiate with third parties for the exploitation of the sport star's image rights. There will be at most one employee, for example the star's manager, to manage the negotiations and possibly one administrative personal. This is not a company conducting day-to-day business operations. The sole purpose of the company is to merely negotiate and contract with third parties for the use of the image rights. The company will then receive the royalty payments for this use. It is therefore simply a passive income that is held offshore in a tax haven and clearly lacks any *bona fide* business purpose. The income is said to be "passive" as these royalty payments are derived from the exploitation of the star's image rights without the IRC being actively involved in the exploitation thereof. It is therefore derived with the minimal effort from the IRC. [336]

The creation of the IRC is abnormal because the sport star or his manager would have been able to negotiate the exploitation of his image rights whilst owning theses rights

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335 *X V Commissioner for the South African revenue service; y v Commissioner for the South African Revenue Service* (IT 24502; IT 24503) [2020] ZATC 16 (12 November 2020) para 61.

336 C Kraamwinkel & W Grimm "CFCs: have we gone too far? – controlled foreign company rules" (2018) 72 *TAXtalk* 29 and National Treasury's Detailed Explanation to Section 9D of the Income Tax Act (2002) 8.

in the sport star's personal capacity. It is unnecessary to first transfer such rights to the IRC for it to achieve the same purpose and it therefore clearly only makes sense for the tax benefit that it provides. Section 80A(a)(i) and (ii) is therefore applicable to this scheme. It is clear that the scheme harbours some dishonesty and the courts will challenge this.[337]

A well-known doctrine that has been applied to these types of avoidance schemes over the years is called the "substance over form" doctrine which in essence entails the court examining "the true nature of the transaction and attach adequate tax implications to it".[338] The most relevant case applicable to this doctrine is the *CSARS v NWK*[339] (referred to as "NWK case"). Initially, the courts only focused on the substance that was the true objective of the transaction rather than the form of the transaction that the taxpayer projected.[340] Once the parties were able to prove to the court that they intended to carry out the terms that was agreed upon, the transaction was not found to be flawed by the courts.[341] In the NWK case the Supreme Court of Appeal expanded the application of this doctrine[342] by introducing the so called "commercial reason" requirement.[343] The learned judge held that the test to determine a simulation is not restricted to whether the intention to give effect to a contract is in accordance with its terms, but the test should go further "and require an examination of the commercial sense of the transaction: of its real substance and purpose".[344] When it is found that the sole purpose of the transaction is to evade tax or a peremptory law, such transaction will be regarded as simulated.[345] This test demonstrate that there should always be a clear business, economical or non-fiscal

337 T Legwaila "Modernising the "Substance over Form" Doctrine: *Commissioner for the South African Revenue Service v NWK Ltd*" (2012) 24 *SA Merc LJ* 115.
338 T Legwaila "Modernising the "Substance over Form" Doctrine: *Commissioner for the South African Revenue Service v NWK Ltd*" (2012) 24 *SA Merc LJ* 115.
339 *CSARS v NWK Ltd (2011)* 2 All SA 347 (SCA).
340 T Legwaila "Modernising the "Substance over Form" Doctrine: *Commissioner for the South African Revenue Service v NWK Ltd*" (2012) 24 *SA Merc LJ* 121.
341 T Legwaila "Modernising the "Substance over Form" Doctrine: *Commissioner for the South African Revenue Service v NWK Ltd*" (2012) 24 *SA Merc LJ* 121.
342 T Legwaila "Modernising the "Substance over Form" Doctrine: *Commissioner for the South African Revenue Service v NWK Ltd*" (2012) 24 *SA Merc LJ* 121.
343 NWK case para 55 read together with J van der Walt "NWK case casting shadows: tax avoidance schemes" (2011) 310 *Tax Breaks* 7.
344 NWK case para 55.
345 NWK case para 55.

financial driver behind every business transaction.[346] As illustrated above, the creation of an IRC to merely negotiate the exploitation of image rights and receive passive royalty payments has the sole purpose to obtain a tax benefit and makes no other commercial sense, this scheme will be regarded as simulated if the NWK business purpose test, which requires commercial reason, is applied to it.

If an avoidance arrangement does not have any tainted elements as listed above, then it must be accepted that the avoidance arrangement constitutes permissible tax avoidance. Such arrangement, although frowned upon by the tax authorities, is allowed. In the discussed example, the author concludes that this scheme entails these tainted elements and will therefore be regarded impermissible tax avoidance. The consequence of impermissible tax avoidance is provided in Section 80B of the Income Tax Act wherein the Commissioner is essentially empowered to disregard or re-characterise any steps that was taken that formed part of the impermissible avoidance arrangement and reallocate any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the guilty party or parties. The Commissioner could therefore find that the royalty payments paid by a third party to the IRC for the exploitation of the star's image rights should form part of the star's gross income and the star will be liable for tax payments as if he received these payments directly in his pocket.

3.7.5 Specific Anti-avoidance Legislation Applicable

3.7.5.1 Controlled Foreign Companies

The assumption is made that the sport star will elect to incorporate the IRC in a "tax haven". The term "tax haven" cannot practically be defined as almost every country in the world will provide lower tax rates in certain activities than other countries and can therefore be seen as tax havens in certain respects.[347] In 1998 the OECD published a report (hereafter the OECD 1998 report) dealing extensively with tax havens and set out four key factors for identifying whether a country is a tax haven. These factors are:

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346 J van der Walt "NWK case casting shadows: tax avoidance schemes" (2011) 310 *Tax Breaks* 8.

347 A W Oguttu "A critique on the OECD campaign against tax havens: has it been successful? A South African perspective" (2010) 172 *Stell LR* 172.

"1) No or nominal tax on the relevant income;

2) Lack of effective exchange of information;

3) Lack of transparency; [and]

4) No substantial activities."[348]

The 1998 report identified three main functions that a tax haven have: one, to provide a location for holding passive investments, secondly a location where "paper" profits can be booked and lastly by enabling the affairs of taxpayers and specifically their bank accounts, to be effectively shielded from the scrutiny of tax authorities of other countries.[349] All of these functions may cause harm to the *fiscus* of other countries as they are likely to facilitate both corporate and individual income tax avoidance and evasion.[350] There are generally three main categories of tax havens: one where no direct tax is charged, such as income tax or capital gain tax, known as "zero-rate tax havens", secondly where a lower tax rate is imposed, known as "low-tax havens", and lastly where tax is levied at a normal rate but the typical tax haven grants individuals and corporations exemptions or preferential treatment for certain types of taxes.[351] The OECD has divided the zero-rate tax havens and the low-rate tax havens into two main categories: tax-haven jurisdictions and harmful preferential tax regimes.[352] The 1998 report distinguished between the two categories by explaining that the zero-rate tax havens are countries who themselves need no or minimal income tax to finance their public services and therefore make themselves available to individuals and corporations to escape tax in their resident country and thereby actively contributing to the erosion of income tax for those resident countries.[353] In contrast, low-tax jurisdictions raise a significant amount of revenue from income tax for to finance their

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348 OECD Harmful Tax Competition: An Emerging Global Issue (1998) available at https://www.oecd.org/tax/harmful/1904176.pdf (Accessed on 20 September 2020) (hereafter the "OECD 1998 report") para 52 23 and OECD "Countering Offshore Tax Evasion: Some Questions and Answers" published on 28 September 2009 available at https://www.oecd.org/ctp/exchange-of-tax-information/42469606.pdf (Accessed on 20 September 2020).

349 OECD 1998 report para 49 22.

350 OECD 1998 report para 50 22.

351 A W Oguttu (2007) "Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts", published LLD thesis, University of South Africa 19 read together with OECD 1998 report para 40 19 - 20.

352 A W Oguttu (2007) "Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts", published LLD thesis, University of South Africa 20 read together with OECD 1998 report para 44 20.

353 OECD 1998 report para 41 and 43 20.

public services, but their tax systems have features constituting harmful tax competition.[354] It is understood that the first category is unlikely to be co-operative in curbing harmful tax competition whilst the latter is more likely to agree on concerted action to curb such practices.[355]

The OECD in the 1998 report made a variety of recommendations for countries to adopt which enhances their domestic legislation to ultimately curb tax avoidance schemes.[356] Some of these recommendations include the implementation of Controlled Foreign Corporations legislation; the introduction of measures that assist other countries to obtain information on request about all foreign activities; furthermore, those that countries should draft a list of existing tax haven jurisdictions and consider terminating existing tax treaties with such jurisdictions in circumstances where they are used to encourage harmful tax competition and refrain from signing tax treaties with such countries in the future.[357] Because tax havens are characterised by their commitment to the common law precedent that provides for the utmost privacy and privilege of information in the banking and commercial sectors,[358] the ultimate recommendation that the OECD made was that there should be adherence to a high standard of transparency and exchange of information in tax matters.[359] The OECD has subsequent to its 1998 report issued a number of other reports wherein it provided its progress in countering harmful preferential jurisdictions and listed jurisdictions with harmful preferential tax regimes that would not comply with its recommendations to adhere to the principles of transparency.[360] In 2009 the OECD issued a progress report wherein it was noted that many positive changes in transparency and exchange of information practices have been made since its original report in 1998 and that there are currently no jurisdiction listed as an uncooperative tax haven by the OECD.[361]

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354 OECD 1998 report para 42 and 43 20.

355 OECD 1998 report para 43 20.

356 A W Oguttu "A critique on the OECD campaign against tax havens: has it been successful? A South African perspective" (2010) 172 *Stell LR* 176.

357 OECD 1998 report see 40 – 62 for all recommendations.

358 A W Oguttu (2007) "Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts", published LLD thesis, University of South Africa 20.

359 A W Oguttu "A critique on the OECD campaign against tax havens: has it been successful? A South African perspective" (2010) 172 *Stell LR* 182.

360 See A W Oguttu "A critique on the OECD campaign against tax havens: has it been successful? A South African perspective" (2010) 172 *Stell LR* for detail on the various reports.

361 OECD "Countering Offshore Tax Evasion: Some Questions and Answers" published on 28 September 2009 available at https://www.oecd.org/ctp/exchange-of-tax-information/42469606.pdf (Accessed on 20 September 2020) 12.

The question that arises in this dissertation is to what extend did South Africa implement the various recommendations by the OECD. South Africa is not a member of the OECD and is therefore not obliged to adopt any recommendations made by the OECD.[362] The OECD Guidelines, even though only binding on its member, have become "a globally accepted standard".[363] South Africa was awarded OECD observer status in 2004[364] and do however participate in a wide variety of OECD activities and is an Associate in 6 OECD bodies and projects, participating in as many as 15 of its bodies and projects.[365] South Africa is an Associate in the Base Erosion and Profit Shifting (hereafter referred to as "BEPS") project.[366] BEPS specifically refers to tax planning strategies that exploit loopholes in tax legislation to artificially shift profits from resident countries to tax havens.[367] To curb these practices, OECD developed 15 actions known as BEPS Actions to equip countries to draft domestic legislation. The actions address tax avoidance by ensuring that profits are taxed in the jurisdiction where economic activities that generate its profits are performed and where value is created, as opposed to an offshore jurisdiction.[368]

Action 3 of the BEPS actions is a Controlled Foreign Company (hereafter "CFC"). The issue to address is when a tax payer strips the tax base of their country of residence by shifting income that would normally accrue to them to a foreign company that is

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362 A W Oguttu "A critique on the OECD campaign against tax havens: has it been successful? A South African perspective" (2010) 172 *Stell LR* 187. For a list of OECD member countries see https://www.oecd.org/about/document/list-oecd-member-countries.htm (Accessed on 20 September 2020).

363 A W Oguttu (2007) "Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts", published LLD thesis, University of South Africa 47.

364 A W Oguttu (2007) "Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts", published LLD thesis, University of South Africa 47.

365 "South Africa and the OECD" accessed on the OECD website https://www.oecd.org/southafrica/south-africa-and-oecd.htm#:~:text=South%20Africa%20is%20an%20Associate,Risk%20of%20Corruption%20(2016). (Accessed on 20 September 2020).

366 "OECD/G20 Inclusive Framework on BEPS: Progress report July 2019 – July 2020" obtained from https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-progress-report-july-2019-july-2020.pdf (Accessed on 27 September 2020) 7 and "South Africa and the OECD" accessed on the OECD website https://www.oecd.org/southafrica/south-africa-and-oecd.htm#:~:text=South%20Africa%20is%20an%20Associate,Risk%20of%20Corruption%20(2016). (Accessed on 20 September 2020).

367 OECD website "What is BEPS" https://www.oecd.org/tax/beps/about/#history (Accessed on 20 September 2020).

368 OECD website "What is BEPS" https://www.oecd.org/tax/beps/about/#history (Accessed on 20 September 2020).

controlled by the taxpayer.[369] Without CFC legislation, there would be an opportunity for a tax payer for profit shifting and long-term deferral of taxation.[370] In 2015, the OECD/G20 published a final report on Action 3[371] (hereafter the "OECD 2015 Final Report on Action 3). This OECD 2015 Final Report on Action 3 considered all the essential elements of CFC rules and breaks them into "building blocks" which should be considered by countries when drafting CFC legislation.[372] These "building blocks" include the following:

> "1. Rules for defining a CFC (including a definition of control);
> 2. CFC exemption and threshold requirements;
> 3. Definition of CFC income;
> 4. Rules for computing income;
> 5. Rules for attributing income; [and]
> 6. Rules to prevent or eliminate double taxation."[373]

South Africa has promulgated CFC legislation in the Revenue Laws Amendment Act 59 of 2000[374] (before this there had been some form of CFC legislation since 1997).[375] In 2016 the Davis Tax Committee (hereafter referred to as "DTC") published a report on BEPS in South Africa[376] which focussed specifically on the OECD 2015 Final Report on Action and found that South Africa already have a robust and extensive

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369 OECD/G20 "Base Erosion and Profit Shifting Profit Shifting Project: Designing Effective Controlled Foreign Company Rules Action 3: Final Report" (2015) obtained from https://www.oecd-ilibrary.org/docserver/9789264241152-en.pdf?expires=1601192892&id=id&accname=guest&checksum=58F6FEBA554C13289B6596A81602D618 (Accessed on 27 September 2020) 9.

370 OECD website "What is BEPS" https://www.oecd.org/tax/beps/about/#history (Accessed on 20 September 2020).

371 OECD/G20 "Base Erosion and Profit Shifting Profit Shifting Project: Designing Effective Controlled Foreign Company Rules Action 3: Final Report" (2015) (hereafter the "OECD 2015 Final Report on Action 3) obtained from https://www.oecd-ilibrary.org/docserver/9789264241152-en.pdf?expires=1601192892&id=id&accname=guest&checksum=58F6FEBA554C13289B6596A81602D618 (Accessed on 27 September 2020) 9.

372 OECD 2015 Final Report on Action 3 11 read together with "Addressing Base Erosion and Profit Shifting in South Africa Davis Committee Interim Report" (2016) prepared by the Davis Tax Committee (DTC) BEPS Sub-committee chaired by Professor A W Oguttu obtained from https://www.taxcom.org.za/docs/New_Folder3/5%20BEPS%20Final%20Report%20-%20Action%203.pdf (Accessed on 27 September 2020) (hereafter referred to as "DTC 2016 Report on Action 3").

373 OECD 2015 Final Report on Action 3 11.

374 National Treasury's Detailed Explanation to Section 9D of the Income Tax Act (2002).

375 DTC 2016 Report on Action 3.

376 DTC 2016 Report on Action 3.

CFC legislation which is largely in line with CFC legislation used by developing countries in Europe.[377] The committee in fact found that the South African CFC legislation is amongst the most sophisticated legislation within the G20.[378] There is however a pitfall to this in that the legislation is very complex and that the law is in some aspects unclear. The committee recommended that consideration should be given by the legislatures to simplify the legislation to ensure clarity.[379] The OECD recognised that tax uncertainty has an adverse effect on trade, investment and economic growth and the fact that the current South African CFC legislation is so unclear in certain respects hinders tax certainty and should therefore be addressed.[380]

CFC legislation in South Africa is contained in Section 9D of the Income Tax Act. As stated above, these rules are of a very technical and complex nature and this dissertation do not intend to provide a detailed analysis of the relevant sections, but to merely describe the extent to which this legislation curbs the use of an IRC by a South African sport star. A company will be regarded a CFC where:

> "more than 50 per cent of the total participant rights in that foreign company are directly or indirectly held by residents (include one or more residents together) or;
> more than 50 per cent of the voting rights in that foreign company are directly or indirectly exercisable by residents (include one or more residents together)"[381].

"Participant rights" means the right to participate in the benefits of the rights attaching to a share in the company (this excludes voting rights).[382] This will typically be the right to distribution of the company's profit by way of receiving a dividend.[383] In the case

377 DTC 2016 Report on Action 3.
378 DTC 2016 Report on Action 3.
379 DTC 2016 Report on Action 3.
380 C Kraamwinkel & W Grimm "CFCs: have we gone too far? – controlled foreign company rules" (2018) 72 *TAXtalk* 31.
381 Section 9D(1)(a) of the Income Tax Act 58 of 1962 read together with M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 846.
382 Part (a) of the definition of participation rights in Section 9D (1) of the Income Tax Act 58 of 1962.
383 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 846.

where the former right is not obtained but the right to exercise any voting rights in the company, such right will also qualify as a "participant right".[384]

In applying the provisions of Section 9D of the Income Tax Act above, the sport star will hold at least 50% of the shares in the IRC. Such an IRC will therefore qualify as a CFC as the star will have more than 50% of the participation and voting rights in the IRC. Should the sport star elect to, for example, only hold 49% shares in his name and, another South African resident (such as a family member) holds 51% of the shares, the IRC will still qualify as a CFC given that the definition specifically provides that when residents, alone or together, holding 50% of the participation and voting rights in the foreign company such company will be a CFC.

Once it has been established that a foreign company is a CFC, Section 9D(2) of the Income Tax Act stipulates that residents who directly or indirectly hold participation rights in the company shall include in their gross income for the year of assessment a portion of the CFC's net income.[385] The IRC is established with the sole purpose that it receives the passive royalty income from the exploitation of the sport star. For the purpose of this scenario, it is accepted that the sport star owns 100% of the shares in the IRC. Once it has been determined that imputation is required, the following step is to calculate the net income of the CFC.[386] There are two instances where the net income of the CFC would be deemed to be nil (and the taxpayer are therefore not required to include any amount to their gross income), namely: the high-tax exemption or the foreign business establishment.[387] These two exemptions will be discussed briefly.

The high-tax exemption is regulated in terms of Section 9D(2A)(i)(aa) of the Income Tax Act. This provision provides that in the instance where the total tax payable to a foreign government by the CFC is equal to or higher than 67.5% of the normal that would have been payable by the CFC had it been a South African tax resident, the net

384 Part (b) of the definition of participation rights in Section 9D (1) of the Income Tax Act 58 of 1962.
385 Section 9D (2) of the Income Tax Act 58 of 1962.
386 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 851.
387 Section 9D (2A) (i) (aa) and Section 9D (2A) (i) (bb) of the Income Tax Act 58 of 1962.

income of the CFC is deemed nil.[388] The rationale for this exemption is to remove the burden of applying CFC rules in cases where there would be little or no tax ultimately due to be paid in South Africa.[389] An example of a foreign government which applies high corporate taxes and in which instance, should the IRC be registered in such jurisdiction CFC would not apply, is the United Arab Emirates with a corporate tax rate of 55%.[390] However, because the sport star in our second scenario incorporated his IRC in a tax haven, this exemption will not apply in this instance as tax havens are notorious for their low corporate tax rates, for example Barbados has a corporate tax rate of only 5.5%.[391]

The second exemption, a foreign business establishment (hereafter "FBE"), is regulated in terms of Section 9D(2A)(i)(bb). A "FBE" in relation to an IRC is defined in Section 9D to *inter alia* mean a business which is suitably staffed and equipped for conducting primary operations of that business incorporated in a foreign jurisdiction.[392] This exemption applies when all receipts and accruals of the CFC are derived from the FBE, and means that the net income of the CFC will be deemed nil.[393] The rationale for this exemption lies in the fact that CFC rules do not target income derived from business activities with substance that are carried outside of South Africa.[394] In our second scenario, the IRC is established with the sole purpose of its member(s) to contract with third parties for the exploitation of the image rights held by the IRC and in return receive passive royalty payment. It is therefore clear that the IRC would not require a large number of staff and would not need to perform daily activities that a FBE would be expected to perform. The IRC is in essence merely a shell company that was incorporated with the sole purpose to receive passive royalty payments and

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388 Section 9D (2A)(i)(aa) of the Income Tax Act 58 of 1962 and M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 851.

389 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 851.

390 E Asen "Corporate Tax Rates around the World, 2019" published on Tax Foundation on 10 December 2019 https://taxfoundation.org/publications/corporate-tax-rates-around-the-world/ (Accessed on 16 October 2020).

391 E Asen "Corporate Tax Rates around the World, 2019" published on Tax Foundation on 10 December 2019 https://taxfoundation.org/publications/corporate-tax-rates-around-the-world/ (Accessed on 16 October 2020).

392 Definition of "foreign business establishment" in part (a)(i) to (v) of Section 9D of the Income Tax Act 58 of 1962.

393 Section 9D (2A)(i)(bb) of the Income Tax Act 58 of 1962.

394 M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 852.

will therefore not meet the definition of an FBE. This exemption would therefore not be applicable to the star.

There will be no exemptions applicable to this structure and Section 9D(2A)(a)(i) of the Income Tax Act stipulates the following:

> "where that foreign company was a controlled foreign company for the entire foreign tax year, the proportional amount of the net income of that controlled foreign company determined for that foreign tax year, which bears to the total net income of that company during that foreign tax year, the same ratio as the percentage of the participation rights of that resident in relation to that company bears to the total participation rights in relation to that company on that last day"

In essence, CFC legislation will apply to the sport star who wishes to shift the income from his image rights that would normally accrue to him to an IRC offshore. This specific anti-avoidance legislation will apply to the scheme at hand and the passive royalty payments received by the star will automatically be included into the star's gross income.

What taxpayers in the past have been doing in order to break the link between the resident holding the participation rights and the CFC, was to create a foreign trust which would hold all the shares in the company.[395] National Treasury became aware and closed this loophole by amending Sections 7(8) and 25B and paragraphs 72 and 80(4) of the Eights Schedule of the Income Tax Act which essentially meant that a foreign trust will no longer be a "CFC blocker" and that the provisions of Section 9D of the Income Tax Act will still apply where the shares are held by a foreign trust to the person to whom the benefit of these participation rights flow.[396]

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395 P Haupt "The Latest Amendments: Foreign Companies held by Foreign Trusts" (2019) 76 *TAXtalk* 50.

396 P Haupt "The Latest Amendments: Foreign Companies held by Foreign Trusts" (2019) 76 *TAXtalk* 50.

3.8 Conclusion

This Chapter set out to discuss two scenarios: the first scenario is where a South African sport star receives monies directly for the exploitation of his image rights and the second is where the same sport star formally assigns his rights to an IRC and then receives money indirectly for the exploitation of these rights.

3.8.1 Scenario One

The star will qualify as a South African tax resident because he met one of two residency tests. The physical presence test in terms of Section 1(a)(ii) of the Income Tax Act by being present in South Africa for a period exceeding 91 days in aggregate during the year of assessment and during each five years of assessment preceding the current year of assessment and for a period exceeding 915 days in aggregate during the five years of assessment preceding the current year of assessment. As it is common for a sport star to participate in a league overseas and to travel for the purpose of participating in matches overseas on a regular basis, it may be that the star is not in the Republic for the periods required by the physical presence test. In such instance, the second test, the ordinary residence test, which is provided in terms of Section 1(a)(i) of the Income Tax Act must be applied. This test in essence entails the question of where the taxpayer considers his “real home” to be. For the purpose of this dissertation, it was accepted that the star is a South African tax resident.

In this scenario, we took a South African sport star “A”, as an example. In our example, he elected to register his image rights as a trade mark in terms of the Trade Marks Act. He owns this trade mark. A then enters into an agreement with Montblanc South Africa whom exploit his image rights by associating his trade mark with their brand in exchange for payment.

The nature of this income must be examined by applying various established principles thereto in order to determine whether it is capital or revenue in nature. In 2001 the ITC 1735 case the court had to decide on this question and concluded that the money received were income in the ordinary sense of the word and cannot be considered as capital in nature. The SARS issued Guide on the Taxation of Professional Sports Clubs and Players agreed with this finding. It must be kept in mind that at the time

when the matter was before the court, the applicable legislation was Section 35(1) and Section 9(1)(b) of the Income Tax Act. These sections have since been repealed.

Furthermore, although there are established principles developed through case law over the years, there is not yet a definite test that can be applied to all scenarios, as stated in WJ *Fourie Beleggings v CSARS* (168/08) [2009] ZASCA 37. Each case will therefore have to be determined based on its own merits and facts. In the example of South African sport star "A", by allowing Montblanc to exploit his image rights as a trade mark and receiving money therefore, the simple "fruit versus tree" analogy[397] can be applied. The image rights which has been registered as a trade mark is the "capital" (i.e. tree) and the payment made by the third party for the exploitation thereof is the "income" (i.e. fruit) that the tree produces. This author therefore find in agreement with the ITC 1735 case and the Guide on the Taxation of Professional Sports Clubs and Players that the money received by the star will be revenue in nature and therefore form part of his gross income. It must be kept in mind that the provisions regulating Royalties, being a withholding tax, will be applicable in the instance where the star receiving the monies is not a tax resident and the third party paying the royalties is a tax resident.

The Guide on the Taxation of Professional Sports Clubs state that should a club with whom the star is employed make payments to the star for the use of his image rights, such payment will constitute "remuneration". This author concludes that this will not automatically be the position in every case. Due to the fact that image rights and the exploitation thereof has become such a large source of income for sport stars over the past years, there will most likely be an image rights section in the star's employment contract. This section will stipulate whether the star's image rights have an independent commercial value and whether the star is the owner of this right, or whether the star consents thereto that his image rights may be exploited by the club as part of his employment services to the club. There is a further complication should the payment to the star be considered to be a "royalty" payment. This will be where the star is a non-resident and the club is resident within the Republic. For these

397 *Visser v CIR* SATC 271 para 276 as discussed under paragraph 3.2.3.2 above.

purposes, the definition of "remuneration" will not include "royalty" payments.[398] Such payment made by the club will directly form part of the star's gross income.

"Gross income" of a tax resident is defined in Section 1 of the Income Tax Act to include the total amount received or accrued to such resident which includes cash or otherwise. The payment made by Montblanc to A will therefore form part of his gross income. South Africa has a progressive rate structure and the highest tax rate for an individual is 45%.[399] For the purpose of this dissertation it is accepted that A will fall into this category. The payment received by him from Montblanc will in scenario one be subject to 45% tax. This is a high tax rate that would be applicable and it is argued in this dissertation that it is for this reason that stars enters into creative tax schemes to try and minimise the amount of tax that would be subject to their image rights income, which leads us to our second scenario.

3.8.2 Scenario Two

In scenario two, the essence of the scheme entered into in lies in the fact that the star assigns his image rights (accepted that it is registered as a trade mark) to an offshore company in which he holds shares that is normally incorporated in a tax haven. In the Guide on the Taxation of Professional Sports Clubs and Players, SARS is of the opinion that a star cannot sell his image rights to a third party because these rights cannot be separated from the sportsperson.[400] This position is disputed by this author for the following brief reasons: In practice, Naas Botha, the past Springbok player previously registered his image rights as a trade mark.[401]

It is further common practice that a trade mark may be assigned as regulated in terms of Part XI of the Trade Marks Act. The statement by SARS is therefore incorrect and

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398 Paragraph (g)(iii) of the definition of "gross income" in Section 1 of the Income Tax Act 58 of 1962 and M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 271 as discussed under paragraph 3.3.1.2.

399 SARS Guide on Income Tax and the Individual (2019/20) 15 as discussed under paragraph 3.2.3.1.

400 SARS *Guide on the Taxation of Professional Sports Clubs and Players* (2018) 34 https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-Gen-G08%20%20Guide%20on%20the%20Taxation%20of%20Professional%20Sports%20Clubs%20and%20Players.pdf (Accessed on 10 September 2018) as discussed under paragraph 3.3.1.3.

401 S Bosse 'Protecting the Image Rights of our Sport Stars' (2008) https://www.bosse-associates.co.za/protecting-the-image-rights-of-our-sport-stars/ (Accessed on 16 April 2018) as discussed in Chapter 2 above.

a sport star will be able to dispose of his image rights by manner of registering same as a trade mark and thereafter formally assigning the trade mark to a third party such as the IRC. This assignment will trigger the disposal of a capital asset in terms of Paragraph 11 of the Eight Schedule of the Income Tax Act (as explained above, the image rights itself is the tree that produces fruits i.e. capital asset). The star will therefore be liable for capital gains tax at the inclusion rate of 40%[402] should there be a capital gain. Because the star and the IRC will be regarded as "connected persons" the value of the image rights will be market value as contemplated in terms of paragraph 38 of the Eight Schedule.

The IRC in the above scenario is incorporated in a "tax haven" [403] and will therefore be a "foreign company". However, Section 1 of the Income Tax Act defines a foreign company as any company which is not a resident. It is therefore important to first look at the definition of a "resident company" in terms of Section 1 of the Income Tax Act. A company will be a "resident" of the Republic if it was incorporated in the Republic, or if its place of effective management is within the Republic. [404] The sport star, being a shareholder of the company, will therefore have to ensure that the key strategic and management decisions of the IRC is taken offshore in the tax haven jurisdiction and that its "effective place of management" is not within the Republic. The "effective place of management" is "where key management and commercial decisions are made"[405].

The very nature of the IRC is to merely own these image rights and to contract with third parties for the exploitation thereof and in return receive passive royalty payments therefor. An example will be to have a designated person residing within the jurisdiction of the tax haven and allowing this person to make all key management and commercial decisions.

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402 Paragraph 10(1)(a) of the Eight Schedule of the Income Tax Act 58 of 1962.

403 See OECD Harmful Tax Competition: An Emerging Global Issue (1998) available at https://www.oecd.org/tax/harmful/1904176.pdf (Accessed on 20 September 2020) (hereafter the "OECD 1998 report") para 52 23 and OECD "Countering Offshore Tax Evasion: Some Questions and Answers" published on 28 September 2009 available at https://www.oecd.org/ctp/exchange-of-tax-information/42469606.pdf (Accessed on 20 September 2020) for relevant factors of a tax haven as discussed in paragraph 3.4.5.1 above.

404 Part (b) of the definition of a resident in Section 1 of the Income Tax Act 58 of 196 as discussed in paragraph 3.2.2 above.

405 Commentary on the OECD Model Tax on Income and on Capital (Full version) as read on 15 July 2014 at paragraph 3 of Article 4 page C(4)-8 as discussed in paragraph 3.2.2 above.

Because the IRC is incorporated in a tax haven, there is an assumption that the company will only be subject to very low commercial taxes. However, the star must receive the income in some indirect manner from the IRC, and here dividends tax becomes relevant. The definition of "gross income" in Section 1 of the Income Tax Act includes an amount received by way of a foreign dividend. However, Section 10B(2)(a) of the Income Tax Act provides for a "participation exemption" which allows a resident to exempt from his income tax a foreign dividend if that person holds at least 10 percent of the total equity shares and voting rights in the company declaring the foreign dividend. It is assumed for the purpose of this dissertation that the sport star will hold more than 10 percent of the total equity shares and voting rights in the IRC and he will therefore qualify for this exemption and not be subject to dividends tax.

As briefly touched upon in scenario one above, the monies paid to the non-resident IRC for the exploitation of the image rights (registered as a trade mark), from a South African resident, will qualify as a cross border transaction on which withholding tax on "royalties" will be applicable. Section 9(1) of the Income Tax Act defines a "royalty" as payments received or accrued in respect of the use, right to use, or permission to use any intellectual property as defined in Section 23I of the Income Tax Act. Section 23I of the Income Tax Act includes trade marks as defined in the Trade Marks Act. A withholding levy of 15% of the amount of any royalty payment is levied. [406] As the non-resident IRC will receive the passive royalty income from a source in South Africa or another jurisdiction, it will be liable for the royalty tax, however the resident third party who pays the royalty to the IRC will be responsible to withhold the tax. Should South Africa and the jurisdiction where the IRC is incorporated have a DTA between them, there may be some treaty relief available to the IRC.

The creation of an IRC is a result of careful tax planning. The question posed in this dissertation is whether such scheme constitutes tax avoidance, tax evasion or simply tax "minimisation". Tax avoidance is where the taxpayer uses the provisions of the fiscal legislation to his advantage. These schemes, although legal, may be so

406 Section 49B(1)(a)(i) of the Income Tax Act 58 of 1962 as discussed under paragraph 3.2.5 above.

aggressive that it reduces the flow of tax revenues into the *fiscus* substantially thus necessitating legislature to create anti-avoidance provisions for the revenue authorities to counter tax avoidance. In order to determine whether a scheme is an impermissible tax avoidance scheme, the provisions of GAAR is used.[407]

The test provided by GAAR essentially entails a two-step inquiry. The first step entails two questions: One, was there an arrangement? In the second scenario, the arrangement is that the sport star assigned his image rights to an IRC which is incorporated in a tax haven with the purpose that the IRC contract with third parties for the exploitation of the image rights. This IRC will receive the passive royalty payments. The star will hold the majority shares in the IRC and will receive these image rights payments indirectly by way of a foreign dividend. Two, was there a tax benefit? In scenario two, the IRC is incorporated and has its place of effective management in a tax haven and will therefore be subjected to very low commercial tax levies. Once the star, being the majority shareholder of the IRC, receives a foreign dividend from the IRC, such foreign dividend will qualify for the "participation exemption" provided for in Section 10B(2)(a) of the Income Tax Act and the dividend will be excluded from his gross income. It is very clear that the star will obtain a tax benefit from this scheme. Once both these questions have been answered in the affirmative, it is accepted that there is an avoidance arrangement.

The second step is an inquiry into whether there are any tainted elements applicable. Should there be tainted elements applicable, the avoidance arrangement will be regarded as impermissible avoidance. In the context of business, the scheme entered into must be abnormal for *bona fide* business purpose and must lack commercial substance. In scenario two, the only reason for the star to enter into such an elaborate scheme where he assigns his image rights to an IRC is merely to create a "wall" between the star and the income received from the exploitation of his image rights. It is abnormal, because the star (possibly with the assistance of his manager) is capable of negotiating with the third parties for the exploitation of his image rights whilst the star is still the owner of these rights. The creation of the IRC is furthermore abnormal

407 General Anti-avoidance Regulations in terms of Sections 80A to 80L of the Income Tax Act as discussed under paragraph 3.4.4 above.

because it will only be a shell company with potentially one or two employees. The only business that the IRC will conduct is the negotiation with third parties for the exploitation of the image rights, as a trade mark, and to receive the passive income in the form of royalty payments. The IRC will therefore lack commercial substance.

The well-known doctrine of "substance over form"[408] will most likely be applied by the courts to this scenario two.[409] This doctrine has been extended by the Supreme Court of Appeal in the NWK case by introducing the "commercial reason" requirement. There is therefore an inquiry by the court into the real substance and purpose of a scheme and a question as to the commercial sense of a transaction. For the reasons given above, the court will very likely find that the creation of an IRC is a simulation transaction with the sole purpose of avoiding tax.

From the above, it is accepted by the author that the scheme will most likely be regarded as an impermissible tax avoidance scheme. In such an instance, Section 80B of the Income Tax Act empowers the Commissioner with various options at his disposal. The Commissioner can either elect to disregard the creation of the IRC in its entirety or can re-characterise any steps that was taken in the creation of this scheme. The Commissioner can also reallocate any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the guilty party or parties. It is therefore possible for the Commissioner to challenge this arrangement and direct that the passive royalty income that the IRC received should form part of the star's gross income.

Should it be found that the star reduced his tax liability by structuring his affairs in such a manner that he commits fraud against the *fiscus*, he will be guilty of tax evasion. In this instance there will be penalties available to SARS in terms of the Tax Administration Act.

In addition to the above general anti-avoidance provisions, South Africa also has specific anti-avoidance provisions that could be applicable to the second scenario

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409 Doctrine defined in *CSARS v NWK Ltd (2011)* 2 All SA 347 (SCA) as discussed under paragraph 3.4.4 in Chapter 3 above.

because an IRC could qualify as a CFC.[410] This is a situation where a tax payer strips the tax base of his country of residence by shifting income that would normally accrue to the taxpayer to a foreign company that is controlled by the taxpayer. There is various international tax legislation that applies to these types of arrangements as discussed under paragraph 3.4.5.1 above. It has been found that South African CFC legislation is up to international standards.

CFC legislation is contained in Section 9D of the Income Tax Act. These provisions are of a very technical and complex nature. It essentially defines a CFC as a foreign company in which 50 per cent of either the total participation rights or in absence thereof, voting rights, are held by South African residents. These rights can be held by a South African resident alone or in conjunction with other residents.

In scenario two, it is accepted by the author that the star will hold the majority of shares in the IRC. The reason for this is that the star would want to receive a big dividend from the IRC for the exploitation of his image rights as this second source of income is the motive for the star to create this elaborate scheme in the first instance. The scheme in scenario two is such an aggressive tax-avoidance scheme that it will not qualify for any of the exemptions provided by CFC legislation. Section 9D(2A)(a)(i) of the Income Tax Act will therefore be applicable and essentially requires the net income of the CFC to form part of the gross income of the South African shareholder in the ratio that such resident holds his percentage participation rights in the CFC. It would also not be possible for the taxpayer to attempt to create a "CFC blocker" by creating a foreign trust whom would hold all the shares because the National Treasury amended various tax legislation to close such loopholes. [411]

It is therefore clear that scenario two holds a significant tax benefit for the star (and thereby reduce the amount of tax to the *fiscus* significantly) and that the aggressive nature of this scheme could permit the tax authorities to challenge such scheme to constitute an impermissible anti-avoidance scheme or apply specific anti-avoidance legislation such as the CFC legislation to the scheme.

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410 Controlled Foreign Company as discussed under paragraph 3.4.5.1 above.

411 P Haupt "The Latest Amendments: Foreign Companies held by Foreign Trusts" (2019) 76 *TAXtalk* 50 as discussed in paragraph 3.4.5.1 above.

In Chapter 4, the specific tax legislation will not be discussed in detail but will rather focus on the specific scenario two scheme that was entered into by stars who are resident in the United Kingdom and Spain. Furthermore, an examination is performed on the tax authorities' treatment of these schemes and the availability of assistive legislation.

Chapter 4: An Analysis of Tax Legislation applied to IRCs in Foreign Jurisdictions

This Chapter consists of three parts. Part A is a brief overview of global tax avoidance regulations, specifically with reference to OECD[412] and BEPS[413] and the requirement of automatic exchange of information. Part B and C will analyse specific case studies in Spain and the United Kingdom respectively. In Chapter 3 there was a detailed discussion on all South African tax laws applicable to image rights and IRCs,[414] which found a significant lack of South African case law depicting a scheme wherein a resident assigns his image rights to an IRC.

The purpose of this Chapter will be to discuss case law in which resident sport stars assigned their image rights and how the courts in the two other jurisdictions perceived these schemes. There will not be a detailed discussion on all tax laws applicable in these jurisdictions and this Chapter will be limited to a brief overview of the general tax laws in order to understand the finding of each court. There will also be a brief overview of the CFC legislation[415] in both Spain and the United Kingdom.

Part A: Global tax avoidance regulations

4.1 Introduction

There is a global battle against international tax avoidance and evasion as cross-border activities becomes a norm in the globalised economy. Over the past few years, jurisdictions around the world have been co-operating in the fight against tax evasion and one key aspect of this is the exchange of information.[416] The basis for the exchange of information is provided by the OECD Multilateral Convention of Mutual Administrative Assistance in Tax Matters and Article 26 of the OECD Model Tax

412 Organisation for Economic Co-operation and Development as defined in Chapter 3.
413 Base Erosion and Profit Shifting as defined in Chapter 3.
414 Image Rights Companies as defined in Chapter 2.
415 Controlled Foreign Companies legislation as discussed in Chapter 3.
416 OECD Automatic Exchange of Financial Information background information brief January 2016 accessed on https://www.oecd.org/ctp/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Brief.pdf (accessed on 5 November 2020) 2.

Convention.[417] In 2009, exchange of information on request (hereafter "EOIR") became an international standard, marking a major breakthrough towards more tax transparency.[418] EOIR is an essential tool that is available to tax authorities' world-wide to utilise during an investigation in order to ensure that the correct amount of tax are paid by tax payers in their jurisdiction.[419] Tax authorities usually enforce the EOIR when they are aware of the fact that a taxpayer have operations and assets in another country. The information that may be requested include bank statements, accounting records and information on the ownership of assets.[420] The EOIR has three key requirements: all jurisdictions must ensure that information regarding the ownership of assets, and accounting and banking records of its tax residents are available; they must provide the jurisdiction requesting the information access to such information; and such information must be exchanged timely with the other jurisdiction with which an agreement is in place.[421] Generally, there must be a legal basis or mechanism for jurisdictions to exchange information for tax purposes.[422] Such legal authority may be derived from domestic law, bilateral or multilateral mechanisms, including but not limited to tax information exchange agreements and double tax conventions.[423] For example in 2012 South Africa entered into a bilateral Tax Information Exchange Agreement (TIEA) with Bermuda for the exchange of information to tax matters.[424] In

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417 Visit the Automatic Exchange of Information (AEOI) portal for a comprehensive overview of the work that the OECD has done and in particular in respect of the Common Reporting Standard http://www.oecd.org/tax/automatic-exchange/.

418 OECD Automatic Exchange of Financial Information background information brief January 2016 accessed on https://www.oecd.org/ctp/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Brief.pdf (accessed on 5 November 2020) 2.

419 OECD Global Forum on transparency and exchange of information for tax purposes accessed on http://www.oecd.org/tax/transparency/what-we-do/ (accessed on 2 December 20202).

420 OECD Global Forum on transparency and exchange of information for tax purposes accessed on http://www.oecd.org/tax/transparency/what-we-do/ (accessed on 2 December 20202).

421 OECD Global Forum on transparency and exchange of information for tax purposes accessed on http://www.oecd.org/tax/transparency/what-we-do/ (accessed on 2 December 20202).

422 OECD Exchange of Information on Request Handbook for Peer Reviews 2016 – 2020 Third Edition '2016 Terms of Reference' accessed on http://www.oecd.org/tax/transparency/documents/terms-of-reference.pdf (accessed on 2 December 2020) 23.

423 OECD Exchange of Information on Request Handbook for Peer Reviews 2016 – 2020 Third Edition '2016 Terms of Reference' accessed on http://www.oecd.org/tax/transparency/documents/terms-of-reference.pdf (accessed on 2 December 2020) 23.

424 Government Gazette Number GG 35048 'Agreement between the Government of The Republic of South Africa and The Government of Bermuda for the exchange of information relating to tax matters' accessed on https://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-EIA-BL-2012-02%20-%20TIEA%20with%20Bermuda.pdf (accessed on 3 December 2020) read together with SARS 'Exchange of Information Conventions / Agreements' https://www.sars.gov.za/Legal/International-Treaties-Agreements/Pages/Exchange-of-Information-Agreements-(Bilateral).aspx (accessed on 3 December 2020).

terms of this agreement, these jurisdiction shall provide assistance to one another through exchange of information that is "relevant to the determination, assessment, enforcement or collection of tax" with respect to the taxpayers who are subject to such taxes and may be utilised during an investigation of tax matters or the prosecution of criminal tax matters in relation to such taxpayer.[425]

The EOIR led to the OECD council approving the Standard for Automatic Exchange of Financial Information (hereafter "the standard") in Tax Matters in 2014.[426] Under this Standard, various jurisdictions obtained information from their financial institutions which is then automatically exchanged with other jurisdictions on an annual basis.[427] This is known as the Common Reporting Standard (hereafter "CRS"). The CRS is designed with a broad scope across three dimensions in order to prevent taxpayer non-compliance. The first dimension is the financial information that is required to be exchanged, which includes all types of investment income and also account balances and proceeds from sales of financial assets.[428] The second dimension is the financial institutions who are required to report under CRS, which "does not only include banks and custodians, but also other institutions such as brokers, certain collective investment vehicles and insurance companies.[429] The last dimension includes accounts held by both individuals as well as entities and includes trusts and foundations".[430]

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425 Article 1 of Government Gazette Number GG 35048 'Agreement between the Government of The Republic of South Africa and The Government of Bermuda for the exchange of information relating to tax matters' accessed on https://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-EIA-BL-2012-02%20-%20TIEA%20with%20Bermuda.pdf (accessed on 3 December 2020)

426 Declaration on Automatic Exchange of Information in Tax Matters adopted on 6 May 2014 accessed on http://www.oecd.org/mcm/MCM-2014-Declaration-Tax.pdf (accessed on 5 November 2020).

427 OECD Automatic Exchange of Financial Information background information brief January 2016 accessed on https://www.oecd.org/ctp/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Brief.pdf (accessed on 5 November 2020) 3.

428 OECD Automatic Exchange of Financial Information background information brief January 2016 accessed on https://www.oecd.org/ctp/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Brief.pdf (accessed on 5 November 2020) 3.

429 OECD Automatic Exchange of Financial Information background information brief January 2016 accessed on https://www.oecd.org/ctp/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Brief.pdf (accessed on 5 November 2020) 4.

430 OECD Automatic Exchange of Financial Information background information brief January 2016 accessed on https://www.oecd.org/ctp/exchange-of-tax-information/Automatic-Exchange-Financial-Account-Information-Brief.pdf (accessed on 5 November 2020) 4.

After the CRS came into effect in 2016, the first exchange of information took place in 2017 (relating to the 2016 *fiscal* year) between 49 jurisdictions.[431] In September 2018 another 51 jurisdiction joined the new CRS Standard. [432]

In practice the aforementioned measures set in place by Article 26 of the OECD Model Tax Convention can be explained as a co-operation between tax authorities in different jurisdictions to share tax information with one another to ensure tax transparency and to address cross border tax avoidance and tax evasion schemes.

BEPS have also included an exchange of information action for companies under Action 13 Country-by-Country Reporting.[433] This action seeks to address the lack of quality data on corporate taxation which made it difficult for tax authorities to measure the *fiscal* and economic effects of tax avoidance on their jurisdiction and to ultimately carry out audits for companies in foreign jurisdictions.[434] This action provides a template for multinational enterprises (known as MNEs) to report specific information for each tax jurisdiction in which they conduct business. This report is called the Country-by-Country (hereafter "CbC") Report.[435] An Action 13 report includes a CbC Reporting Implementation Package which facilitates the implementation of the CbC Reporting standard. This package consists of two parts. The first is model legislation which is available for use by any country to compel the ultimate parent entity of an MNE group to file the CbC Report in its jurisdiction of residence. The second is three model Competent Authority Agreements that is available for countries to use to facilitate the implementation of the exchange of CbC Reports.[436]

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431 Blevins & Franks "UK tax office benefits from global exchange of information" published on 28 March 2019 https://www.blevinsfranks.com/news/article/HMRC-benefits-from-global-exchange-of-information (Accessed on 11 November 2020).

432 Blevins & Franks "UK tax office benefits from global exchange of information" published on 28 March 2019 https://www.blevinsfranks.com/news/article/HMRC-benefits-from-global-exchange-of-information (Accessed on 11 November 2020). For a full list of countries who have stated that they are committed to adhere to the automatic exchange of information as updated on 16 September 2020 visit http://www.oecd.org/tax/transparency/AEOI-commitments.pdf (Accessed on 11 November 2020). South Africa was among the first 49 jurisdictions who automatically exchanged information in 2017.

433 OECD BEPS Action 13 Country-by-Country Reporting accessed on https://www.oecd.org/tax/beps/beps-actions/action13/ (Accessed on 5 November 2020).

434 OECD BEPS Action 13 Country-by-Country Reporting accessed on https://www.oecd.org/tax/beps/beps-actions/action13/ (Accessed on 5 November 2020).

435 OECD BEPS Action 13 Country-by-Country Reporting accessed on https://www.oecd.org/tax/beps/beps-actions/action13/ (Accessed on 5 November 2020).

436 OECD BEPS Action 13 Country-by-Country Reporting accessed on https://www.oecd.org/tax/beps/beps-actions/action13/ (Accessed on 5 November 2020).

4.2 Part A: Conclusion

It is clear from the above that the key element to curbing global tax avoidance is complete transparency and exchange of information between various jurisdictions.

South Africa, Spain and the United Kingdom were among the first 49 jurisdictions who exchanged information in 2017.[437] In March 2019 the United Kingdom published its "No Safe Havens 2019" policy paper[438] stating that the United Kingdom has seen "huge changes and improvements in offshore tax compliance in recent years"[439] owing this success to the fact that more than 100 jurisdictions have committed to the automatic exchange of information under the new Standard CRS.[440] The United Kingdom reportedly received information of approximately 3 million United Kingdom resident individuals or companies they control in the year 2018, which enabled them to detect possible tax non-compliance.[441]

What the Standard practically means for South Africa when examining the example of South African sport star "A" incorporating an IRC in a tax haven as set out in Chapter 3 is that the South African tax authorities will be able to utilise both the EOIR and CRS standards in order to obtain information regarding the IRC from the jurisdiction where the IRC is incorporated. This will also lead to an improvement in offshore tax compliance as it has for other jurisdictions such as the United Kingdom.

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437 For a full list of countries who have stated that they are committed to adhere to the automatic exchange of information as updated on 16 September 2020 visit http://www.oecd.org/tax/transparency/AEOI-commitments.pdf (Accessed on 11 November 2020).

438 The "No Safe Havens 2019" policy and all related information can be obtained from https://www.gov.uk/government/publications/no-safe-havens-2019 (Accessed on 11 November 2020).

439 The "No Safe Havens 2019" policy paper: introduction accessed on https://www.gov.uk/government/publications/no-safe-havens-2019/no-safe-havens-2019-introduction (Accessed on 11 November 2020).

440 The "No Safe Havens 2019" policy paper: introduction accessed on https://www.gov.uk/government/publications/no-safe-havens-2019/no-safe-havens-2019-introduction (Accessed on 11 November 2020) read together with Blevins & Franks "UK tax office benefits from global exchange of information" published on 28 March 2019 https://www.blevinsfranks.com/news/article/HMRC-benefits-from-global-exchange-of-information (Accessed on 11 November 2020).

441 The "No Safe Havens 2019" policy paper: introduction accessed on https://www.gov.uk/government/publications/no-safe-havens-2019/no-safe-havens-2019-introduction (Accessed on 11 November 2020).

Part B: Spain

4.3 Introduction

It is widely known that Spain's national sport is football. The Spanish football league, La Liga, is regarded as one of the most competitive football leagues in Europe.[442] Naturally, this attracts a plethora of famous football players from around the world who come to play in Spain. In fact, one of the reasons why Spain became so competitive in football across Europe is because of its history of implementing special laws designed specifically for the taxation of athletes.[443]

4.4 General Taxation in Spain

The Spanish system for direct tax comprises of two main types of personal income tax. Spanish personal income tax (PIT) for residents, and Spanish non-residents' income tax (NRIT) for non-residents.[444] Individuals who obtain income in Spain are therefore either liable to pay Spanish PIT or Spanish NRIT.[445]

For an individual to qualify as a Spanish resident for tax purposes, one of the following tests must be passed:[446]

(1) Spend more than 183 days in Spain during a given calendar year. An individual is still regarded as being present in Spain during sporadic absence unless the

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442 Just Landed 'Football in Spain The National Sport' https://www.justlanded.com/english/Spain/Articles/Culture/Football-in-Spain (Accessed on 27 September 2020) and Topend sports 'Sport in Spain' https://www.topendsports.com/world/countries/spain.htm (Accessed on 27 September 2020).

443 A. D. Appleby 'Leveling the Playing Field: A Separate Tax Regime for International Athletes' (2011) 36 *Brooklyn Journal of International Law* 630.

444 PWC 'Spain Individual – Taxes on personal income' last reviewed on 16 July 2020 https://taxsummaries.pwc.com/spain/individual/taxes-on-personal-income (Accessed on 26 September 2020).

445 PWC 'Spain Individual – Taxes on personal income' last reviewed on 16 July 2020 https://taxsummaries.pwc.com/spain/individual/taxes-on-personal-income (Accessed on 26 September 2020).

446 Article 9 of Law 35/2006 dated 28 November 2006, titled Personal Income Tax (machine translated on https://www.global-regulation.com/translation/spain/1446075/law-35-2006-of-28-november%252c-personal-income-tax-and-partial-modification-of-the-tax-laws-tax%252c-non-resident-income-and-on-capital.html) (hereafter the Spanish Income Tax Act); M Akers 'A Race to the Bottom: International Income Tax Regimes' Impact on the Movement of Athletic Talent' (2015) 17 *University of Denver Sports and Entertainment Law Journal* 25, A. D. Appleby 'Leveling the Playing Field: A Separate Tax Regime for International Athletes' (2011) 36 *Brooklyn Journal of International Law* 631 and KPMG 'Spain – Income Tax' published on 31 January 2020 https://home.kpmg/xx/en/home/insights/2011/12/spain-income-tax.html (Accessed on 26 September 2020).

individual can prove their tax residence status in another jurisdiction. Should such jurisdiction be a tax haven, it may be required that the individual should have spent at least 183 days during the calendar year in that jurisdiction[447]; or

(2) Have his "centre of economic interest" in Spain. This entails that the resident's "base or core" of his economic or professional activities are in Spain. A test that could be applied to determine this is to ask whether the taxpayer earns more income or has more assets in Spain than in any other single country.[448] The taxpayer will also be presumed to have habitual (ordinary) residence in Spain in terms of this subsection if his "centre of vital interest" is in Spain. An example of this would be where the taxpayer's non-separated spouse and/or his dependent minor children reside in Spain. In this instance the taxpayer is presumed to be a Spanish resident even in the event that he spends less than 183 days in Spain, unless he can prove otherwise.[449]

Spanish regulations do not provide for a partial-year residence status and an individual is therefore only classified as either a tax resident or a non-resident which will apply to such individual for the full tax year.[450]

Resident individuals are subjected to progressive-rate income tax, which is approved by the state. The scale that is approved by the state can be used as a guideline of the progressive tax rates applicable for the general taxable base.[451] There is also an applicable rate that is approved by each autonomous community of Spain in their progressive tax rate scales.[452] This means that the tax liability may differ from one

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447 Article 9(1)(a) of the Spanish Income Tax Act.

448 Article 9(b) of the Spanish Income Tax Act read together with Belvins & Franks 'Spanish residence and taxes. Are you sure you are getting it right? https://www.blevinsfranks.com/news/article/spanish-residence-and-taxes (Accessed on 11 November 2020).

449 Article 9(b) of the Spanish Income Tax Act read together with Belvins & Franks 'Spanish residence and taxes. Are you sure you are getting it right? https://www.blevinsfranks.com/news/article/spanish-residence-and-taxes (Accessed on 11 November 2020).

450 Article 9 of the Spanish Income Tax Act read together with KPMG 'Spain – Income Tax' published on 31 January 2020 https://home.kpmg/xx/en/home/insights/2011/12/spain-income-tax.html (Accessed on 26 September 2020).

451 Article 2 of the Spanish Income Tax Act read together with PWC 'Spain Individual – Taxes on personal income' last reviewed on 16 July 2020 https://taxsummaries.pwc.com/spain/individual/taxes-on-personal-income (Accessed on 26 September 2020).

452 Article 2 of the Spanish Income Tax Act read together with PWC 'Spain Individual – Taxes on personal income' last reviewed on 16 July 2020

autonomous community to another.[453] Therefore, the scale approved by the state should always be consulted together with the applicable scale in the corresponding community of Spain to calculate the total progressive tax rate.[454]

4.5 Taxation of Image Rights

Other than in South Africa[455], Spanish image rights constitutes a personality right, are recognised by Spanish law, and even enjoys Constitutional protection.[456] The Spanish Constitution stipulates in Section 18(1) that every person has the right thereto that personal and family privacy shall be honoured and that the right to each person's own image is guaranteed'.[457] The purpose of this constitutional protection is to prohibit a third party from unjustly infringing another's image right.[458] The Constitutional Court defines the right to image as a right that belongs to an individual and that stems from his dignity. The individual has the right to determine what graphic information may be generated from his physical features. The power that is granted to the individual in terms of this right consists essentially of the right to prevent a third party from obtaining, reproducing or publishing the individual's image for whatever purpose without the individual's prior consent. [459]

https://taxsummaries.pwc.com/spain/individual/taxes-on-personal-income (Accessed on 26 September 2020).

453 PWC 'Spain Individual – Taxes on personal income' last reviewed on 16 July 2020 https://taxsummaries.pwc.com/spain/individual/taxes-on-personal-income (Accessed on 26 September 2020).

454 Article 2 of the Spanish Income Tax Act read together with PWC 'Spain Individual – Taxes on personal income' last reviewed on 16 July 2020 https://taxsummaries.pwc.com/spain/individual/taxes-on-personal-income (Accessed on 26 September 2020).

455 Image rights are not yet recognised in South African law as discussed in Chapter 2.

456 Senn Ferrero Sport & Entertainment 'Spanish tax situation of image rights' by E Montejo http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights (Accessed on 22 September 2020).

457 Section 18(1) of the Spanish Constitution sanctioned by his Majesty the King before the courts generals on December 27, 1978.

458 L. J. D. Garcia 'Image Rights: Spanish Taxation' (2017) EPFL Legal Newsletter #5 https://us12.campaign-archive.com/?u=6e691aba6d240b5f49d576cea&id=d65d52eb2d (Accessed on 22 September 2020).

459 Various judgments of the Spanish constitutional Court cited as 81/2001; 922/1998; 4184/2000 and 127/2003 as quoted and translated in Senn Ferrero Sport & Entertainment 'Spanish tax situation of image rights' by E Montejo http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights (Accessed on 22 September 2020).

The image right also entitles the owner of the right to negotiate with another party to exploit his image, either for free or for profit, all of which requires the permission of the owner of the right.[460] This right has been defined by the Constitutional Court[461] as:

> "the personality right that gives its holder the power to freely determine their appearance and external physical characteristics, to publish or produce them freely, and to prevent unauthorised third parties from obtaining, reproducing or publishing recognisable physical characteristics of their physical image without their consent".[462]

This right to one's own image was developed by Spanish legislators by means of Organic Law 1/1982.[463] The main objective of this law was to provide a framework for civil protection of the fundamental rights established in Section 18 of the Spanish Constitution.[464]

4.5.1 Image rights within the framework of an employment relationship

As explained in Chapter 2 of this dissertation, image rights can either form part of an employment contract, or the sport star can negotiate with the club to have exclusive control of his image rights. In the latter instance, the sport star will be able to negotiate with companies who wishes to exploit his image rights by way of entering into a commercial contract. This distinction is regulated in the Spanish Royal Decree 1006/1085[465] which deals with special labour relationships of professional sportspersons. From the wording of articles 1.3, 7.3 and 8 of the Spanish Royal Decree 1006/1085, a distinction is drawn between the image rights' income earned by a sport star from his employer (the club) and image rights' income derived from a commercial

460 Senn Ferrero Sport & Entertainment 'Spanish tax situation of image rights' by E Montejo http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights (Accessed on 22 September 2020).

461 Decision of the Spanish Constitutional Court number 72/2007 (First Courtroom), 16th April 2007.

462 Y. V. Moraga & A Sarrias 'Sport Image Rights in Spain' (2010) 3-4 *The International Sport Law Journal* 123.

463 Organic Law 1/1982, dated 5th May, titled Regarding civil protection of the right to dignity, personal and family privacy and one's own image.

464 Y. V. Moraga & A Sarrias 'Sport Image Rights in Spain' (2010) 3-4 *The International Sport Law Journal* 124.

465 Royal Decree 1006/1985 of 26 June which Regulates the Special Employment Relationship of Professional Athletes (machine translated to English and accessed on https://www.global-regulation.com/translation/spain/1479087/royal-decree-1006---1985%252c-of-26-june%252c-which-regulates-the-special-employment-relationship-of-professional-athletes.html).

relationship. When such income is received in terms of the Collective Labour Agreement and a particular employment contract, it will be considered to be a salary, and is taxed accordingly.

Should it arise from a commercial relationship between a sport star and a company for advertising or sponsorship purposes, it will not be considered to constitute a salary but will be taxed as income that is of a revenue nature.[466]

The Football Collective Labour Agreement[467] explicitly states in Articles 24 and 32 that two conditions must first be met before image rights income can be categorised as a salary, namely:

(1) The direct exploitation of the image rights must be carried out by the sport star himself; and
(2) The direct exploitation must be concluded between the football player and the club hiring him.[468]

Accordingly, to distinguish image rights payments as being a salary payment or revenue in nature, one must consider with whom the sport star concluded the contract for the exploitation of his image rights. Should the star have concluded a contract with his club as part of his employment contract, the club has the right to exploit his image rights. Remuneration for the exploitation thereof will be in the form of a salary and would not constitute additional income for the star.

4.5.2 85/15% Rule (imputation of image revenue)

Income derived from the exploitation of image rights will be subject to PIT or NIRT depending on whether the sport star is a tax resident or a non-resident of Spain.

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466 L. J. D. Garcia 'Image Rights: Spanish Taxation' (2017) EPFL Legal Newsletter #5 https://us12.campaign-archive.com/?u=6e691aba6d240b5f49d576cea&id=d65d52eb2d (Accessed on 22 September 2020).

467 Spanish Football Collective Labor Agreement enacted in November 23, 2015 as cited in L. J. D. Garcia 'Image Rights: Spanish Taxation' (2017) EPFL Legal Newsletter #5 https://us12.campaign-archive.com/?u=6e691aba6d240b5f49d576cea&id=d65d52eb2d (Accessed on 22 September 2020).

468 L. J. D. Garcia 'Image Rights: Spanish Taxation' (2017) EPFL Legal Newsletter #5 https://us12.campaign-archive.com/?u=6e691aba6d240b5f49d576cea&id=d65d52eb2d (Accessed on 22 September 2020).

Historically, it was a well-known practice for football clubs to search widely for international star football players and to sign contracts with these stars in order to remain competitive. This resulted in large remuneration payments, for both the on-field performance by the sport star as well as the exploitation of the star's image rights. The receipt of these significant amounts of remuneration, in turn meant a significant tax liability for these sport stars.

The assignment of image rights to IRCs (typically incorporated in tax havens) became an attractive option for these sport stars as it made it possible for sport stars to significantly reduce their tax burden.[469] The assignment was achieved by either the club or the sport star ceding the image rights to the IRC whereby that portion of income due to the sport star as remuneration (in the form of a salary) or as additional income for the exploitation of his image rights, was received by the IRC.

The implementation of this structure resulted in a reduction of the sport stars' remuneration, tax liability and the clubs' corresponding withholding tax liability that would apply to employment income.[470] This IRC would pay substantially less tax and allow the sport star to only pay tax once he obtained income from the investments in the company in the form of a dividend or similar items.[471]

The resident star will be subject to PIT for the dividend income earned on a progressive scale. For the first €6 000, a rate of 19% will apply, for the following €6 000 to €50 000 tax at a rate of 21% and a 23% tax rate on any remaining amount of income will be applicable.[472] Foreign dividend earned by Spanish residents who are natural persons are generally not exempt from tax, unless the participation exemption applies.[473]

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469 Y. V. Moraga & A Sarrias 'Sport Image Rights in Spain' (2010) 3-4 *The International Sport Law Journal* 131.

470 E Montejo and C Carnero 'Comparative tax approach of major European leagues' (2018) 13 *Global Sports Law and Taxation Reports* 10.

471 Y. V. Moraga & A Sarrias 'Sport Image Rights in Spain' (2010) 3-4 *The International Sport Law Journal* 132.

472 PWC 'Spain Individual – Taxes on personal income' last reviewed on 16 July 2020 https://taxsummaries.pwc.com/spain/individual/taxes-on-personal-income (Accessed on 26 September 2020).

473 Article 80 of the Spanish Income Tax Act read together with Deloitte 'International Tax: Spain Highlights 2020' last reviewed in January 2020 https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-

Dividends earned from shareholding in Spanish and foreign subsidiary companies may be exempted if such dividends are received by a legal person with a participation of at least 5% in the subsidiary for at least a one-year period.[474] This does not apply to natural persons and it is therefore accepted that the dividends received by a Spanish sport star will not be exempted from tax.

The aforementioned structure has the sole purpose of shifting income that would normally be received by the sport star and will consequently be subject to tax in Spain (either as PIT for the star or withholding tax for the club) to an offshore jurisdiction and thereby avoiding tax payment on image rights income.[475] In order to prevent this form of tax avoidance, the Spanish tax authorities introduced the Law 13/1996 of 30 December on Fiscal, Administrative Measures and social order.

This became known as the 85/15 rule[476] and has the following requirements for application of the rule:[477]

(1) The sport star, being a tax resident in Spain, assigns his right to the exploitation of his image rights to an IRC, whether such IRC is a tax resident or non-resident;
(2) The sport star provides their services in terms of an employment relationship to a club, whether such club is a tax resident or non-resident;
(3) The club with which the sport star has an employment relationship exploits the image rights of the said sport star and pay the IRC for the exploitation of the image rights; and

spainhighlights-2020.pdf (Accessed on 12 November 2020) and Euro Economics 'Dividend taxes Spain' https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-spainhighlights-2020.pdf (Accessed on 12 November 2020).

474 Article 80 of the Spanish Income Tax read together with Euro Economics 'Dividend taxes Spain' https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-spainhighlights-2020.pdf (Accessed on 12 November 2020).

475 Senn Ferrero Sport & Entertainment 'Spanish tax situation of image rights' by E Montejo http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights (Accessed on 22 September 2020).

476 Y. V. Moraga & A Sarrias 'Sport Image Rights in Spain' (2010) 3-4 *The International Sport Law Journal* 131.

477 Senn Ferrero Sport & Entertainment 'Spanish tax situation of image rights' by E Montejo http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights (Accessed on 22 September 2020) and Y. V. Moraga & A Sarrias 'Sport Image Rights in Spain' (2010) 3-4 *The International Sport Law Journal* 132.

(4) The income received by the IRC for the exploitation of image rights may not exceed 15% of the total remuneration paid by the club to the sport star. In other words, a sport star or his employer (the club) may only assign 15% of the image rights held to an IRC. The remaining 85% must be held directly by either the club or the sport star, depending on the contractual employment relationship in relation to the sport star's image rights.

This rule therefore allows the limited assignment of image rights to companies, even where they are registered in tax havens, limiting the amount that can be ceded to such company to 15% of the sum of the remuneration in the form of a salary and that which was obtained from the assignment of the image rights.[478] Should this limit be exceeded, all income received by the IRC shall be taxed in the hands of the sport star. For example, if the percentage of income that was paid to the IRC was 16%, the full amount of income paid to the company would form part of the sport star's income tax liability in Spain (and not merely the 1% exceeding the 15% limit).[479]

The aforementioned rule is now regulated in terms of Article 91 of the Spanish Income Tax Act and are referred to as the "Imputation of income in the international tax transparency regime".[480]

4.5.3 Beckham law

In June 2005, the Royal Decree 633/2005[481] came into force, which amended the existing personal income tax regime in Spain. It allowed individuals who entered Spain

478 Y. V. Moraga & A Sarrias 'Sport Image Rights in Spain' (2010) 3-4 *The International Sport Law Journal* 132.

479 Senn Ferrero Sport & Entertainment 'Spanish tax situation of image rights' by E Montejo http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights (Accessed on 22 September 2020).

480 Spanish government website translated to English 'Income Practical Manual 2019' Chapter 10: Special regimes: imputation and attribution of income accessed on https://www.agenciatributaria.es/AEAT.internet/en_gb/Inicio/Ayuda/Manuales__Folletos_y_Videos/Manuales_practicos/IRPF/_Ayuda_IRPF_2019/Capitulo_5__Rendimientos_del_capital_mobiliario/Rendimientos_del_capital_mobiliario__cuestiones_generales/Clasificacion_segun_su_origen_o_fuente/Cuadro__Clasificacion_de_los_rendimientos_segun_su_procedencia/Cuadro__Clasificacion_de_los_rendimientos_segun_su_procedencia.html (Accessed on 27 November 2020).

481 Royal Decree 633/2015 of 10 July 2015 which regulated the amendment of the Regulation of the tax on personal income tax (machine translated to English and accessed on https://www.global-regulation.com/translation/spain/615991/royal-decree-633-2015%252c-10-

on a labour contract and remained in the country for over 183 days in a tax year to be taxed as non-residents, thereby only being taxed on their Spanish-sourced income as opposed to being taxed on their worldwide income as a tax resident.[482] The purpose of this decree was to stimulate the weakening Spanish economy by promoting the arrival of valuable foreign workers to Spain.[483] The nickname for this decree, the "Beckham law"', arose due to the fact that the main beneficiaries of this amendment at the time were foreign football players, and David Beckham was among first people to benefit from this tax-exemption scheme, when he joined Real Madrid football club from Manchester United football club.[484] This law presented Spanish football clubs with a great advantage compared to other European countries as it provided a tax benefit for these stars that would not be available to them in other European jurisdictions.[485]

The Beckham law allows expatriates who newly moved to Spain during the course of their employment, to elect whether the resident or non-resident tax treatment would be applicable to them during the year they arrived in Spain, and for the subsequent five years.[486] If an individual elected to be taxed as a non-Spanish resident, their world-wide income and assets would be exempted from tax in Spain.[487] The expatriate will

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july%252c-that-amending-the-regulation-of-the-tax-on-physical-persons-income%252c-approved-by-the-royal-decree-439-2007%252c-of-.html).

482 E Montejo and C Carnero 'Comparative tax approach of major European leagues' (2018) 13 *Global Sports Law and Taxation Reports* 10.

483 The lawyers portal 'Football and the Law: The Beckham Law (part one) by H Kwafo-Akoto https://www.thelawyerportal.com/blog/football-and-the-law-the-beckham-law-part-one/ (Accessed on 22 September 2020);

484 The lawyers portal 'Football and the Law: The Beckham Law (part one) by H Kwafo-Akoto https://www.thelawyerportal.com/blog/football-and-the-law-the-beckham-law-part-one/ (Accessed on 22 September 2020); BBC News 'Why are Spanish football stars in legal trouble?' by J Badcock on 17 June 2017 https://www.bbc.com/news/world-europe-40287173 (Accessed on 22 September 2020) and Senn Ferrero Sport & Entertainment 'Spanish tax situation of image rights' by E Montejo http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights (Accessed on 22 September 2020).

485 Senn Ferrero Sport & Entertainment 'Spanish tax situation of image rights' by E Montejo http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights (Accessed on 22 September 2020).

486 M Akers 'A Race to the Bottom: International Income Tax Regimes' Impact on the Movement of Athletic Talent' (2015) 17 *University of Denver Sports and Entertainment Law Journal* 27.

487 The lawyers portal 'Football and the Law: The Beckham Law (part one) by H Kwafo-Akoto https://www.thelawyerportal.com/blog/football-and-the-law-the-beckham-law-part-one/ (Accessed on 22 September 2020).

still be taxed on his Spanish-source income.[488] To be eligible for this election, the new Spanish resident must meet the following requirements:[489]

(1) The sport star must not have been a Spanish tax resident in the ten years prior to the move;
(2) The sport star must have moved to Spain as a consequence of his employment with a club; and
(3) The sport star must effectively perform work for a Spanish resident (club).

For David Beckham, the effect was that his tax affairs were subject to NRIT and consequently paid tax on a flat rate of only 24% on income under €600 000 as opposed to a progressive PIT rate of 45%.[490] The personal advantage for Beckham was that income derived from the exploitation of his image rights received from world-wide sources such as his lifetime endorsement deal with Adidas (which was valued at the time to be $160 million), was not subject to Spanish taxation due to the source of the income being outside of Spain.[491]

This law was criticised as it allowed wealthy foreign workers to derive a tax benefit in circumstances where Spanish residents remained subject to the progressive tax scale on their net world-wide income.[492] From 1 January 2010, the Spanish legislature amended the Beckham law to include an additional qualifying requirement that the anticipated remuneration would need to be below the gross amount of €600 000 (approx. R6.3 million)[493] per year.[494] The effect of this additional requirement is that it

488 C Carnero and E Montejo 'Comparative tax approach of major European leagues' (2018) 13 *Global Sports Law and Taxation Reports* 10.
489 M Akers 'A Race to the Bottom: International Income Tax Regimes' Impact on the Movement of Athletic Talent' (2015) 17 *University of Denver Sports and Entertainment Law Journal* 27.
490 The lawyers portal 'Football and the Law: The Beckham Law (part one) by H Kwafo-Akoto https://www.thelawyerportal.com/blog/football-and-the-law-the-beckham-law-part-one/ (Accessed on 22 September 2020).
491 The lawyers portal 'Football and the Law: The Beckham Law (part one) by H Kwafo-Akoto https://www.thelawyerportal.com/blog/football-and-the-law-the-beckham-law-part-one/ (Accessed on 22 September 2020).
492 The lawyers portal 'Football and the Law: The Beckham Law (part one) by H Kwafo-Akoto https://www.thelawyerportal.com/blog/football-and-the-law-the-beckham-law-part-one/ (Accessed on 22 September 2020).
493 In January 2010 the Euro ZAR exchange rate was 10.6 as obtained from https://www1.oanda.com/currency/converter/ (Accessed on 12 November 2020).
494 M Akers 'A Race to the Bottom: International Income Tax Regimes' Impact on the Movement of Athletic Talent' (2015) 17 *University of Denver Sports and Entertainment Law Journal* 27 and Senn Ferrero Sport & Entertainment 'Spanish tax situation of image rights' by E Montejo

excluded a majority of the top earning football players from the application of the Beckham law, based on the fact that these players normally earn above the figure of €600 000 per year.[495]

The latest amendment to the Beckham law was passed on 1 January 2015, when this regime was modified to such an extent that it became impossible to apply to any new football players of Spanish clubs. The new amendment specifically provided that professional sports-persons are excluded from the application of this regime.[496] Notably, after this amendment there has been a significant increase in the number of tax investigations by the Spanish tax authorities into the tax status of foreign football players in the Spanish Leagues.[497]

4.6 The Lionel Messi Case

Football boasts two billionaires, Lionel Messi and Cristiano Ronaldo.[498] Their millions are made both on and off the field of play and, predictably, both stars have had encounters with the Spanish tax authorities for not declaring money earned from their image rights. Messi earns a salary of €78 million for his on-field performance with an

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http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights (Accessed on 22 September 2020).

495 Senn Ferrero Sport & Entertainment 'Spanish tax situation of image rights' by E Montejo http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights (Accessed on 22 September 2020).

496 Foresight Consultancy 'The "Beckham" law – Spain's favourite personal tax regime' published on April 2016 https://www.google.com/search?q=beckham+law+2015&rlz=1C1GCEU_enZA847ZA847&oq=beckham+law+2015&aqs=chrome..69i57j35i39l2j0l2j69i60l3.4309j0j7&sourceid=chrome&ie=UTF-8 (Accessed on 3 September 2020) and Senn Ferrero Sport & Entertainment 'Spanish tax situation of image rights' by E Montejo http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights (Accessed on 22 September 2020).

497 Law in Sport 'Why Spain's approach to taxing image rights and agency income is discouraging overseas footballers' by C Carnero and E Montejo published 1 March 2019 https://www.lawinsport.com/topics/item/why-spain-s-approach-to-taxing-image-rights-and-agency-income-is-discouraging-overseas-footballers?highlight=WyJpbnRlcm1lZGlhcmllcyIsIidpbnRlcm1lZGlhcmllcyIsImludGVybWVkaWFyaWVzJywiLCJpbnRlcm1lZGlhcmllcyciLCInaW50ZXJtZWRpYXJpZXMnIiwiaW50ZXJtZWRpYXJpZXMnOSJd#sdfootnote9sym (Accessed on 12 November 2020).

498 Forbes 'The World's Highest-Paid Soccer Players 2020: Messi wins, Mbappe Rises' posted on 14 September 2020 https://www.forbes.com/sites/christinasettimi/2020/09/14/the-worlds-highest-paid-soccer-players-2020-messi-wins-mbappe-rises/#14fd72df1cff (Accesseed on 6 October 2020) and Complex UK 'Lionel Messi Becomes Football's Second Billionaire' by J Davey posted on 17 September 2020 https://www.complex.com/sports/2020/09/lionel-messi-billionaire-footballer (Accessed on 6 October 2020).

additional €28 million (approx.) for the exploitation of his image rights.[499] The star's father foresaw that his son is likely to make millions from his image rights and attempted to divest a plan to curb the high taxes payable on this source of income, as will be discussed below.

In June 2013, a Spanish prosecutor filed a complaint against the football star Lionel Messi and his manager, who is also his father, alleging that they owe €4.2 million in taxes for the fiscal years 2007 to 2009.[500] The reason for the complaint was their creation of a network of IRCs to which their image rights were assigned.[501] Messi and his father had already repaid €5 million to the Spanish tax authorities in 2013, however the prosecutor continued to pursue his complaint against them.[502] The complaint can be exhibited as follows:

In March 2005, before Messi obtained the age of majority, Messi's father and mother in the exercising of their parental authority assisted him to assign his image rights to an IRC known as 'Sport Consultants Ltd' (hereafter "SC") with a registered office in the tax haven jurisdiction, Belize.[503] This assignment was concluded for a price of €38 040 for a period of 10 years, which was extendable.[504] This insignificant value led authorities to believe it was a simulated transaction as it could not possibly represent an actual image rights agreement concluded at an arm's length price.[505] The contract also made provision for the assignee (the IRC) to assign image rights that it acquired to third parties, with the sole condition that the assignor (this would represent Messi) must be informed of such assignment.[506] The shares of SC are owned by Messi's

499 Forbes 'The World's Highest-Paid Soccer Players 2020: Messi wins, Mbappe Rises' posted on 14 September 2020 https://www.forbes.com/sites/christinasettimi/2020/09/14/the-worlds-highest-paid-soccer-players-2020-messi-wins-mbappe-rises/#14fd72df1cff (Accesseed on 6 October 2020).

500 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

501 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

502 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14 and Sportskeeda 'Chronicling Lionel Messi's tax fraud case' published on 6 July 2016 by S Nalagandia https://www.sportskeeda.com/football/th (Accessed on 3 September 2020).

503 Supreme Court Criminal Chamber 1729/2016 Judgment (translated to English) (hereafter the "Lionel Messi Judgment') read together with J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

504 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

505 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

506 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

mother since February 2005.[507] When Messi obtained the legal age of majority in 2006, he ratified the assignment contract (hereinafter referred to as "the contract") before a Notary Public in Barcelona.[508] There are an array of legal consequences for this contract which will be set out below.

The purpose of this contract was to formally unlink Messi from the income that his image rights would generate, by assigning these rights to an IRC (SC) incorporated in a tax haven, which will own such rights and the income it produces. Through the use of an agency contract, SC (now the owner of the image rights) granted a license to Sports Enterprises Ltd (hereafter 'SE') with a registered office in the United Kingdom, as the exclusive agent for the commercial and advertising exploitation of the image rights of Lionel Messi worldwide, with the unique exception in the United Kingdom itself.[509] For the rendering of these services, SE would receive commission of 10% of net profit received from the commercial and advertising exploitation of the image rights.[510] Fifty percent of the shares in SE was owned by Messi's father, Jorge Messi.[511]

In 2006, SC entered into a contract for the management of sponsorship contracts, merchandising etc. with a company known as Lazario GmbH (hereafter "LZ") which was registered in Switzerland. In return, SC would receive a commission of between 5% and 8% on the net payments derived from such contracts.[512] LZ was the property of "Vitop Consulting AG", also registered in Switzerland and whose declared activity involves performing fiduciary functions.[513]

In 2006, a mere four days after Messi ratified the formation of SC, the company concluded a six-year contract with Adidas to the value of €9 million (€1.5 million each

507 The Lionel Messi Judgment read together with J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.
508 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.
509 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.
510 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.
511 The Lionel Messi Judgment read together with J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.
512 The Lionel Messi Judgment read together with J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.
513 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

year).[514] The value was received by SC, and because SC was incorporated in Belize this had numerous tax advantages for the star. Belize is known as an offshore tax haven largely because of the famous corporate structure known as the International Business Company (hereafter "IBC").[515] Any offshore company that is incorporated in Belize is exempted from local taxation, including corporate income tax, capital gain tax and dividend tax.[516]

The structure that was formed to manage the image rights was replaced in 2007, by introducing new companies which replaced the previous companies in the structure. In the new structure, SC was substituted by another company, Jenbril SA (hereafter 'JB') at no fee. SE was substituted by Sidefloor Ltd (hereafter 'SF') and LZ was substituted by Tubal Soccer Management GmbH (hereafter 'TSM') which is also a shareholder of "Vitop Consulting AG". The new companies in the structure continued to transact in terms of the image rights of the player from 2007.[517] Messi's mother and father were the shareholders of these new companies, as with the previous structure.

It is clear from the above structure that it was intended to build a "wall" between Messi and the income received from the exploitation of his image rights in order to protect him against the tax due for this stream of income.[518] It is also evident from the structure that every company, person or institution that wanted to exploit the image rights of Lionel Messi had to conclude a contract with a company that was registered in countries with local beneficial tax policies such as the tax privilege regime in Switzerland.[519] This was represented by SE and LZ in the first structure and

514 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

515 OffShore Company Corporation 'The advantages of tax for incorporating a company in Belize' updated on 10 August 2020 accessed on https://www.offshorecompanycorp.com/bt/en/insight/jurisdiction-update/the-advantages-of-tax-for-incorporating-a-company-in-belize (Accessed on 3 December 2020) read together with Offshore Protection 'International Offshore Jurisdiction Spotlight – Belize as a Tax Haven updated on 30 August 2020 accessed on https://www.offshore-protection.com/belize-tax-havens (Accessed on 3 December 2020).

516 OffShore Company Corporation 'The advantages of tax for incorporating a company in Belize' updated on 10 August 2020 accessed on https://www.offshorecompanycorp.com/bt/en/insight/jurisdiction-update/the-advantages-of-tax-for-incorporating-a-company-in-belize (Accessed on 3 December 2020) read

517 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

518 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

519 KPMG 'Switzerland: Voters approve tax reform measures in referendum' updated on 20 May 2019 https://home.kpmg/xx/en/home/insights/2019/05/tnf-switzerland-voters-approve-tax-reform-measures-in-referendum.html (Accessed on 28 December 2020) It should be noted that the previous privilege regime has been repealed with effect on 1 January 2020.

substituted by SF and TSM (incorporated in United Kingdom and Switzerland) in the second one.[520]

The applicable tax laws allowed for income earned from outside of Spain's territory to be directed towards the tax haven (Belize) where Messi's image rights assignees companies (IRCs), SC in the first structure substituted by JB in the second one, were registered.[521]

Figure 2 illustrates the aforementioned scheme:

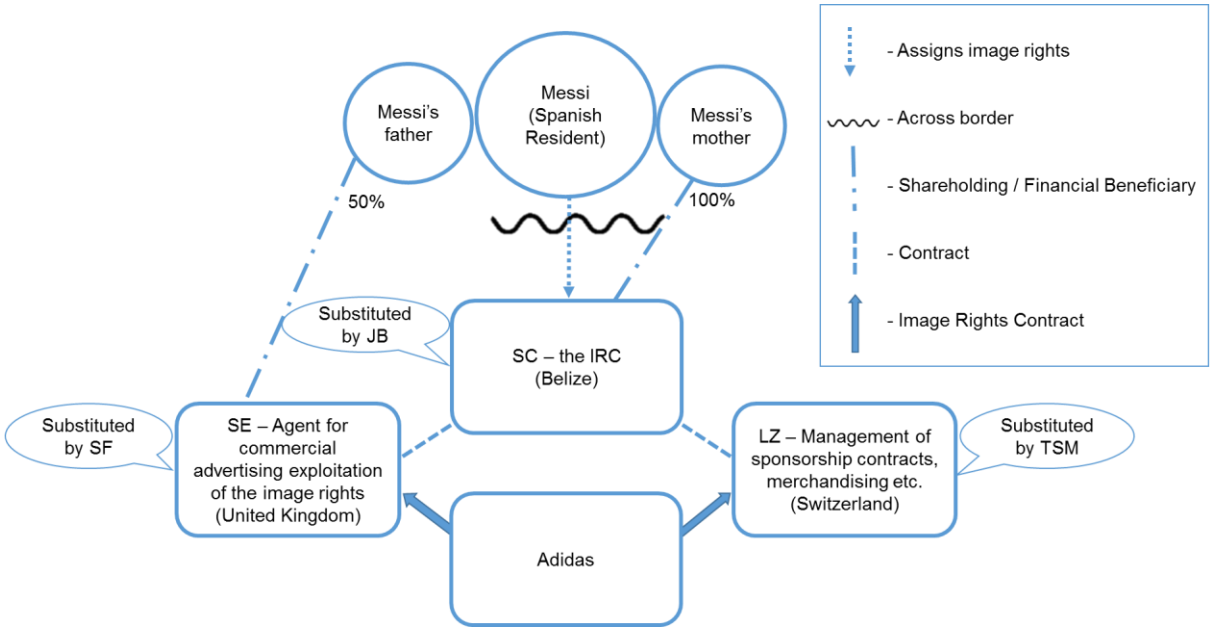

Figure 2 - The Messi IRC Structure

The prosecutor's complaint against this complex structure during the years 2007 to 2009 was that Messi and his father had evaded a total of almost €4.2 million in tax.[522] In July 2014, the Spanish court moved forward with their prosecution. There were media reports that the prosecuting authorities were of the opinion that Messi's father was the party responsible for these elaborate schemes which were believed to amount

520 Double Taxation Agreement between the United Kingdom and Belize accessed on https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/728087/belize-uk-dta-1947.pdf (Accessed on 3 December 2020) and Double Taxation Agreement between Switzerland and the United Kingdom accessed on https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/539603/1977_SwitzerlandUK.pdf (Accessed on 3 December 2020) read together with J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

521 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

522 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 14.

to tax fraud.[523] Messi's defence from the outset was that he was completely unaware of the tax schemes that was created.[524] Reportedly, there were various appeals made to the Judge during October 2014 and June 2015 to drop the charges against Messi personally due to the fact that it was his father alone who was responsible for the star's finances, which was rejected by the Judge.[525] The court held that Messi should not be granted immunity merely because he himself did not have proper knowledge of his own finances. The court held that Messi had known enough to stand trial for the tax schemes as it was impossible for the star to have had no knowledge of the wrongdoings of his father and other financial advisors at the time.[526] In June 2016 during trial Messi stated in his defence "I was playing football, I knew nothing".[527]

The prosecutor accused the player and his father of three tax offences, one for each year, categorised in Article 305 of the Spanish Penal Code.[528] This article currently provides that:

> "[an] offence against the treasury is punishable with a prison sentence between two and six years and a fine of between twice and six times the amount defrauded, where the fraud takes (sic) is committed in any of the following circumstances:
> (a) The amount defrauded exceeds six hundred thousand Euros.
> (b) The fraud was committed within an organisation or criminal group.
> (c) where the use of natural or legal persons or entities without legal personality as proxies, business or trust instruments or tax havens or territories with no tax obscures or makes it difficult to determine the identity of the taxpayer or the

523 Sportskeeda 'Chronicling Lionel Messi's tax fraud case' published on 6 July 2016 by S Nalagandia https://www.sportskeeda.com/football/th (Accessed on 3 September 2020).
524 Sportskeeda 'Chronicling Lionel Messi's tax fraud case' published on 6 July 2016 by S Nalagandia https://www.sportskeeda.com/football/th (Accessed on 3 September 2020).
525 Sportskeeda 'Chronicling Lionel Messi's tax fraud case' published on 6 July 2016 by S Nalagandia https://www.sportskeeda.com/football/th (Accessed on 3 September 2020).
526 Sportskeeda 'Chronicling Lionel Messi's tax fraud case' published on 6 July 2016 by S Nalagandia https://www.sportskeeda.com/football/th (Accessed on 3 September 2020).
527 Sportskeeda 'Chronicling Lionel Messi's tax fraud case' published on 6 July 2016 by S Nalagandia https://www.sportskeeda.com/football/th (Accessed on 3 September 2020).
528 Organic Act 10/1995, dated 23rd November 2013, on the Criminal Code.

person responsible for the offence, the amount defrauded or the assets of the taxpayer or the person responsible for the offence".[529]

As the complaint relates to transactions occurring during the period 2007 to 2009 when Article 305 of the Spanish Penal Code in its previous form would have to be applied and would result in a penalty of between one and four years prison sentence.[530] Article 305 of the Spanish Penal Code has since been amended to create harsher consequences for tax offences. In 2010 the maximum term of imprisonment was increased to five years and again in 2012, when Article 305.bis was included to regulate the position as set out above. [531]

On 6 July 2016, the Spanish Supreme Court found both Messi and his father guilty of defrauding the Spanish tax authorities between 2007 and 2009 to the amount of €4.1 million.[532] Messi was fined €2 million and his father was fined €1.5 million.[533] Messi and his father were both also handed a jail sentence of 21 months.[534] Messi and his father never served time in jail as Article 81 of the Spanish Penal Code states that the execution of a sentence is usually suspended for first time offenders in circumstances where the sentence handed down does not exceed a period of two years. Messi appealed against his sentence, however it was rejected by the Spanish Supreme Court in June 2017.[535]

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529 Article 305 bis of Organic Act 10/1995 (added by singe art. 3 of Organic Law 7/2012 of 27 December 2012).

530 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 15.

531 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 15.

532 BBC News 'Lionel Messi tax fraud prison sentence reduced to fine' published on 7 July 2017 https://www.bbc.com/news/world-europe-40534761#:~:text=Football%20star%20Lionel%20Messi's%2021,court%20said%20in%20a%20statement. (Accessed on 22 September 2020).

533 V Pattiasine *et al* 'Determinants of Taxpayer Compliance Level: Empirical Study in East Indonesia' (2020) 5(1) *The Journal of Research on the Lepidoptera* 340 and BBC News 'Lionel Messi tax fraud prison sentence reduced to fine' published on 7 July 2017 https://www.bbc.com/news/world-europe-40534761#:~:text=Football%20star%20Lionel%20Messi's%2021,court%20said%20in%20a%20statement. (Accessed on 22 September 2020).

534 V Pattiasine *et al* 'Determinants of Taxpayer Compliance Level: Empirical Study in East Indonesia' (2020) 5(1) *The Journal of Research on the Lepidoptera* 340.

535 BBC News 'Lionel Messi tax fraud prison sentence reduced to fine' published on 7 July 2017 https://www.bbc.com/news/world-europe-40534761#:~:text=Football%20star%20Lionel%20Messi's%2021,court%20said%20in%20a%20statement. (Accessed on 22 September 2020).

The prosecutor alleged that the above tax evasion scheme mainly relied on the anonymity of the real owners of the various companies incorporated in jurisdictions such as the United Kingdom, Switzerland, Uruguay and Belize, once again confirming the importance of transparency and exchange of information between various jurisdictions.[536]

4.7 The Cristiano Ronaldo Case

While playing for Real Madrid Football Club, Cristiano Ronaldo received €52 million in salary and winnings each year.[537] In addition to this already lucrative salary, the star earns millions, said to be in the region of €40 million yearly, from the exploitation of his image rights.[538] He is liable for tax on both his salary from the club as well as income derived from the exploitation of his image rights. In an attempt to minimize his tax liability, Ronaldo's financial advisors entered into creative schemes as discussed below.

In 2008, after Ronaldo signed a contract with Real Madrid, the star ceded his image rights to Tollin Associates Ltd (hereafter 'TA'), a company with its registered office in the British Virgin Islands, a well-known tax haven or low tax jurisdiction.[539] The sole stakeholder of this company was Ronaldo himself.[540] In turn, TA ceded the image rights to a company in Ireland, named Multisports & Image Management Ltd (hereafter "MIM") which was neither owned nor controlled by Ronaldo.[541] The Spanish Prosecutor alleged that MIM did not have any business activity and was merely an

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536 Global Witness 'Messi's alleged tax evasion scheme relief on hiding the owners of UK and other companies' press release on 31 July 2014 https://www.globalwitness.org/en/archive/messis-alleged-tax-evasion-scheme-relied-hiding-owners-uk-and-other-companies/ (Accessed on 12 November 2020).

537 G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

538 G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

539 G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

540 G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

541 G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

offshore shell company with the sole purpose of receiving passive income for the exploitation of image rights.[542] MIM was the IRC responsible for the management of the image rights of Ronaldo and for contracting with third parties such as Nike, Toyota and Emirates for the exploitation of these image rights.[543]

By incorporating MIM in Ireland, it had the advantage of paying only 12.5% corporate tax on the profits received, which was lower than the Spanish corporate tax rate of 25%.[544] The image rights contract was drafted in such a manner that MIM negotiated the image rights contracts with third parties, and in return received 24% to 26% of Ronaldo's annual advertising revenue as commission.[545] The remainder of the royalty payments was received directly by TA in the British Virgin Islands. [546] Third parties however only negotiated and contracted with MIM. [547] The previous lack of transparency and exchange of information from tax havens was utilised in order to conceal the income received from the exploitation of Ronaldo's image rights.[548]

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542 Sport and Taxation 'Image Rights: Cristiano Ronaldo facing €15 million tax fraud case in Spain' by I Blackshaw posted on 13 June 2017 https://www.sportsandtaxation.com/2017/06/image-rights-cristiano-ronaldo-facing-e15-million-tax-fraud-case-in-spain/ (Accessed on 12 November 2020).

543 G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

544 El Mundo "Football Leaks" published on 3 December 2016 by P Stew and J Sanchez https://www.elmundo.es/deportes/football-leaks/2016/12/02/5841d852468aeb61028b462b.html (Accessed on 13 November 2020).

545 El Mundo "Football Leaks" published on 3 December 2016 by P Stew and J Sanchez https://www.elmundo.es/deportes/football-leaks/2016/12/02/5841d852468aeb61028b462b.html (Accessed on 13 November 2020).

546 El Mundo "Football Leaks" published on 3 December 2016 by P Stew and J Sanchez https://www.elmundo.es/deportes/football-leaks/2016/12/02/5841d852468aeb61028b462b.html (Accessed on 13 November 2020) and G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

547 El Mundo "Football Leaks" published on 3 December 2016 by P Stew and J Sanchez https://www.elmundo.es/deportes/football-leaks/2016/12/02/5841d852468aeb61028b462b.html (Accessed on 13 November 2020) and G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

548 El Mundo "Football Leaks" published on 3 December 2016 by P Stew and J Sanchez https://www.elmundo.es/deportes/football-leaks/2016/12/02/5841d852468aeb61028b462b.html (Accessed on 13 November 2020) and G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

Naturally, Ronaldo had to receive the money from TA in some form or another, being the sole shareholder of TA. Such payment to Ronaldo would then be in the form of a taxable dividend which is not exempted from PIT for a Spanish tax resident. In order to prevent this, Ronaldo utilised the 'Beckham Law', as set out above, which allowed Ronaldo to elect to be taxed as a non-Spanish resident, meaning that only the income derived from the exploitation of his image rights within Spain would be subject to tax, and not those derived from any other international jurisdictions.[549] It is said that in terms of the abovementioned scheme, Ronaldo merely paid four percent of his total income to the Spanish treasury.[550] As stated above, this law was however amended in 2015 to exclude professional sport players earning above a certain threshold.

Figure 3 illustrates the aforementioned scheme:

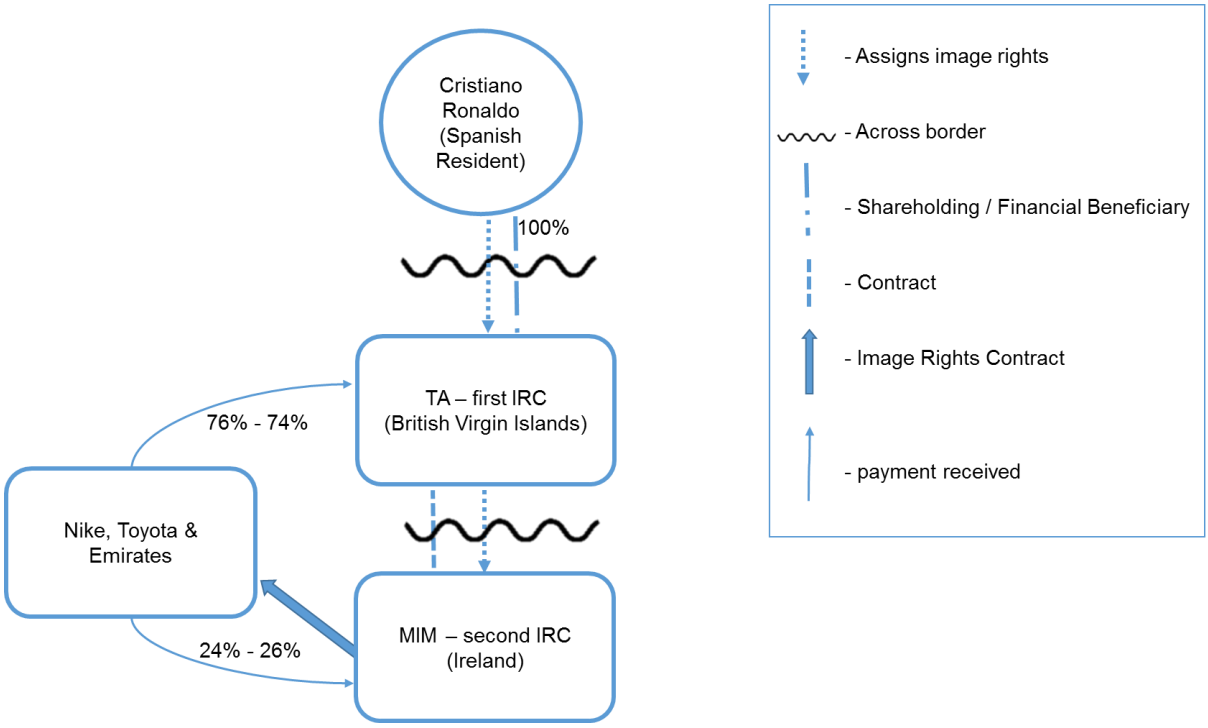

Figure 3 - The Ronaldo IRC Structure

549 G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

550 G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

In anticipation of the fact that the Beckham law would no longer be available to the star, Ronaldo sold his image rights for a mere €68 million to a Singaporean businessman named Peter Lim in a six-year contract.[551] When asked about this, Ronaldo simply stated that it was a strategic move to take his brand to the next level.[552]

In applying the same law as set out in Messi's case above[553], the claim against Ronaldo was that the star had been defrauding the Spanish tax authorities with irregular image rights structures in the years 2011 to 2014, evading a total of €14.8 million in tax.[554] The prosecutor alleged that the star had used these shell companies, registered in a tax haven, to create a wall between him and the income derived from the exploitation of his image rights with the ultimate goal to hide his total income from Spain's tax officials.[555] The charge included the allegations that the star "intentionally" failed to declare income of €28.4 million of income derived from the exploitation of his image rights and that there was a "voluntary" and "conscious" failure to meet his tax obligations in Spain.[556] The star declared that his total income for the years between 2011 and 2014 was €11.5 million, whilst in actual fact it was found to be in the region

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551 G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

552 G Jurgen 'How The World's Best Footballers Play The Tax Game' published on 22 February 2019 https://medium.com/swlh/how-the-worlds-best-footballers-play-the-tax-game-bf586c73b16a (Accessed on 26 September 2020).

553 Article 305 bis of Organic Act 10/1995 (added by singe art. 3 of Organic Law 7/2012 of 27 December 2012).

554 EL Païs 'Spain's tax authority accepts Cristiano Ronaldo deal: €19 million and two-year suspended jail term' published on 26 July 2018 https://english.elpais.com/elpais/2018/07/26/inenglish/1532613639_389065.html (Accessed on 22 September 2020) and The Guardian 'Ronaldo agrees to pay €19m fine to settle tax fraud case' by S Jones published on 22 January 2019 https://www.theguardian.com/football/2019/jan/22/ronaldo-fine-tax-fraud-case-madrid#:~:text=The%20Portugal%20and%20Juventus%20footballer,23%2Dmonth%20suspended%20prison%20sentence. (Accessed on 3 October 2020).

555 The Guardian 'Ronaldo agrees to pay €19m fine to settle tax fraud case' by S Jones published on 22 January 2019 https://www.theguardian.com/football/2019/jan/22/ronaldo-fine-tax-fraud-case-madrid#:~:text=The%20Portugal%20and%20Juventus%20footballer,23%2Dmonth%20suspended%20prison%20sentence. (Accessed on 3 October 2020).

556 The Guardian 'Ronaldo agrees to pay €19m fine to settle tax fraud case' by S Jones published on 22 January 2019 https://www.theguardian.com/football/2019/jan/22/ronaldo-fine-tax-fraud-case-madrid#:~:text=The%20Portugal%20and%20Juventus%20footballer,23%2Dmonth%20suspended%20prison%20sentence. (Accessed on 3 October 2020) and EL Païs 'Spain's tax authority accepts Cristiano Ronaldo deal: €19 million and two-year suspended jail term' published on 26 July 2018 https://english.elpais.com/elpais/2018/07/26/inenglish/1532613639_389065.html (Accessed on 22 September 2020).

of €43 million.[557] In 2018, an agreement was reached between the star and the Spanish tax authorities which saw the amount that was evaded reduced to €5.7 million which was subject to interest and a fine. Ultimately, it was agreed that the star was liable for €19 million with a suspended jail sentence of two years.[558] This deal was concluded by an order of court on 22 January 2019.[559]

4.8 Controlled Foreign Companies: Spain

Spain incorporated CFC laws[560] in 1995 as part of a member of the EU to comply with the EU requirements contained in the Anti-Tax Avoidance Directive[561] which have adopted some of the recommendations made by the OECD.[562]

A foreign company is considered a CFC if 50% or more of its voting rights, share of capital, equity or profits is controlled either directly or indirectly by a Spanish tax-resident shareholder.[563] This is known as the "control test".[564] This test is combined with the jurisdictional approach which entails that a foreign company is considered a

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557 The Guardian 'Ronaldo agrees to pay €19m fine to settle tax fraud case' by S Jones published on 22 January 2019 https://www.theguardian.com/football/2019/jan/22/ronaldo-fine-tax-fraud-case-madrid#:~:text=The%20Portugal%20and%20Juventus%20footballer,23%2Dmonth%20suspended%20prison%20sentence. (Accessed on 3 October 2020).

558 EL Païs 'Spain's tax authority accepts Cristiano Ronaldo deal: €19 million and two-year suspended jail term' published on 26 July 2018 https://english.elpais.com/elpais/2018/07/26/inenglish/1532613639_389065.html (Accessed on 22 September 2020).

559 The Guardian 'Ronaldo agrees to pay €19m fine to settle tax fraud case' by S Jones published on 22 January 2019 https://www.theguardian.com/football/2019/jan/22/ronaldo-fine-tax-fraud-case-madrid#:~:text=The%20Portugal%20and%20Juventus%20footballer,23%2Dmonth%20suspended%20prison%20sentence. (Accessed on 3 October 2020).

560 Spain Income Tax Act.

561 Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market accessed on https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.193.01.0001.01.ENG.

562 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the World: Spain' published on 4 February 2020 by S Duenas and D Bunn https://taxfoundation.org/spain-cfc-rules/#:~:text=Under%20Spanish%20legislation%20a%20foreign,combined%20with%20the%20jurisdictional%20approach (Accessed on 12 November 2020).

563 Article 91 of the Spain Income Tax Act read together with Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the World: Spain' published on 4 February 2020 by S Duenas and D Bunn https://taxfoundation.org/spain-cfc-rules/#:~:text=Under%20Spanish%20legislation%20a%20foreign,combined%20with%20the%20jurisdictional%20approach (Accessed on 12 November 2020).

564 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the World: Spain' published on 4 February 2020 by S Duenas and D Bunn https://taxfoundation.org/spain-cfc-rules/#:~:text=Under%20Spanish%20legislation%20a%20foreign,combined%20with%20the%20jurisdictional%20approach (Accessed on 12 November 2020).

CFC in circumstances where the corporate income tax that is paid by that company is less than 75% of the tax that would have been paid in Spain.[565] These CFC rules only apply to passive income received by the foreign company.[566] Royalty payments for the exploitation of image rights that have been registered as a trade mark specifically qualifies as passive income and such passive income received by an IRC will therefore be subject to the CFC laws.

CFC laws will apply when the foreign company does not have "an adequate structure", which the Spanish legislator considers to be a company without any human resources and material operations.[567] The onus of proof lies on the foreign company to proof that there is a specific reason for the existence of the foreign company.[568] If the purpose of the foreign company is not demonstrated, all the income derived from its operations must be included in the tax base of the Spanish tax resident.[569] However, if there is an active business structure the CFC laws will not be applicable.[570]

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565 Article 91 of the Spain Income Tax Act read together with Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the World: Spain' published on 4 February 2020 by S Duenas and D Bunn https://taxfoundation.org/spain-cfc-rules/#:~:text=Under%20Spanish%20legislation%20a%20foreign,combined%20with%20the%20jurisdictional%20approach (Accessed on 12 November 2020).

566 Article 91 of the Spain Income Tax Act read together with Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the World: Spain' published on 4 February 2020 by S Duenas and D Bunn https://taxfoundation.org/spain-cfc-rules/#:~:text=Under%20Spanish%20legislation%20a%20foreign,combined%20with%20the%20jurisdictional%20approach (Accessed on 12 November 2020).

567 Article 91 of the Spain Income Tax Act read together with Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the World: Spain' published on 4 February 2020 by S Duenas and D Bunn https://taxfoundation.org/spain-cfc-rules/#:~:text=Under%20Spanish%20legislation%20a%20foreign,combined%20with%20the%20jurisdictional%20approach (Accessed on 12 November 2020).

568 Article 91 of the Spain Income Tax Act read together with Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the World: Spain' published on 4 February 2020 by S Duenas and D Bunn https://taxfoundation.org/spain-cfc-rules/#:~:text=Under%20Spanish%20legislation%20a%20foreign,combined%20with%20the%20jurisdictional%20approach (Accessed on 12 November 2020).

569 Article 91 of the Spain Income Tax Act read together with Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the World: Spain' published on 4 February 2020 by S Duenas and D Bunn https://taxfoundation.org/spain-cfc-rules/#:~:text=Under%20Spanish%20legislation%20a%20foreign,combined%20with%20the%20jurisdictional%20approach (Accessed on 12 November 2020).

570 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the World: Spain' published on 4 February 2020 by S Duenas and D Bunn https://taxfoundation.org/spain-cfc-rules/#:~:text=Under%20Spanish%20legislation%20a%20foreign,combined%20with%20the%20jurisdictional%20approach (Accessed on 12 November 2020).

The CFC legislation in Spain is less complicated than in South Africa and is aligned with the standards recommended by the OECD.[571]

4.9 Conclusion – Part B

It is clear that there is a big football culture in Spain and the government was initially so keen to attract football stars that Spain enacted favourable tax legislation such as the Beckham law.[572] Because football is so famous and its stars' image rights are generally worth a vast amount of money, Spain can be regarded as being pro-active with its legislation that focus specifically on the taxation of image rights income. Perhaps a pitfall of Spain's initial eagerness to attract these football stars with favourable tax legislation are the fact that the stars tend to enter into minimisation schemes to continue to enjoy the benefit of lower taxes and in some cases attempt to evade tax on the income received from their image rights in its entirety.

The two case studies above clearly indicate that the Spanish tax authorities are inclined to prosecute football players and have an acute interest in those who are famous enough to derive a significant income from the exploitation of their image rights.[573] It appears that the Spanish Penal Code is structured in such a manner that enables it to be applied to a typical scenario where the star assigns his image rights to an IRC with the sole purpose of defrauding the Spanish tax authorities. It is unlikely for these stars to serve jail time in light of the fact that Spanish courts have the discretion to suspend jail sentences of up to two years. What is clear however is that Spain imposes hefty fines on top of interest accrued on the amount that was evaded, and that this is, in the opinion of this dissertation, a satisfactory anti-avoidance law available to the Spanish tax authorities.

The CFC laws in Spain are likely to apply to an IRC because an IRC lacks commercial substance, which is the main requirement for Spain's CFC laws to be applicable. The

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571 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the World: Spain' published on 4 February 2020 by S Duenas and D Bunn https://taxfoundation.org/spain-cfc-rules/#:~:text=Under%20Spanish%20legislation%20a%20foreign,combined%20with%20the%20jurisdictional%20approach (Accessed on 12 November 2020).

572 As discussed under paragraph 4.5.3 above.

573 J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 16.

more simplified CFC laws could assist the Spanish tax authorities to easily conclude that the profits of the IRC should be included in the tax base of the Spanish sport star.

What I find to be of most value is the specific legislation known as the 85/15% Rule which are now contained in Article 91 of the Spanish Income Tax Act.[574] This is specific anti-avoidance legislation that have been drafted to ensure that at least 85% of the income received from image rights are imputed in the gross income of the sport star and thereby curbing the typical tax avoidance associated with the creation of an IRC minimisation scheme.

Part C: United Kingdom (hereafter "UK")

4.10 Introduction

The Football Association's Premier League was formed in 1992.[575] The very first football games aired on 16 August 1992 and since then, the football industry in the UK went from strength to strength and a number of top football stars from around the world move to the UK to play in the Premier League.[576] In the season of 1991/92, the combined revenues of all 22 clubs that formed part of the old First Division were approximately £170 million. [577] In the 2018/19 season, Manchester United alone generated a total revenue of €711.5 million, the highest in the Premier League.[578] Broadcasting revenue forms a large part of the income generated by football clubs in the Premier League, which in return enable the clubs to offer large salaries to attract the world's best players.[579] As the sums of money and sizes of transactions increased, priorities shifted to commercial and specialist legal contractual skills and agents started to focus on the stars' remuneration.[580] The term 'image rights' has been said to enter the minds of most British football fans in around 2000 when Real Madrid

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574 As discussed under paragraph 4.5.2 above.

575 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.

576 P Hackleton 'The current legal status of image rights companies in football' published on 5 July 2016 on LawInSport https://www.lawinsport.com/topics/item/the-current-legal-status-of-image-rights-companies-in-football (Accessed on 16 August 2020) and R Haynes 'Footballers' Image Rights in the New Media Age' (2007) 7(4) *European Sport Management Quarterly* 363.

577 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.

578 D Lange 'Manchester United total revenue 2005-2019' posted on 11 February 2020 on Statista https://www.statista.com/statistics/271665/revenue-of-manchester-united/ (Accessed on 7 October 2020).

579 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.

580 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.

signed the Portuguese midfielder Luis Figo from Barcelona.[581] Central to the negotiations was the club's retention of the star's image rights which enabled them to exploit the stars name and image on their merchandise and to share in the profit from any personal endorsements that the player attained from sponsorships or advertising.[582]

Part of the sport stars' contract negotiations is the net salary that the star will earn after tax, and most agents therefore build a tax aspect into their negotiation with the football club.[583] When the football stars perform well, their agents regularly seek to renegotiate their contracts and attempting to increase their salary, which places immense pressure on the club.[584] In the past, a number of clubs have established rigid wage structures including a wage ceiling, and were reluctant to agree to deals in excess of the maximum.[585] This system appeared to work when it was applied equally to all the players at the club, but the difficulty arose when an exceptional star insisted on a higher salary. Should the club make an exception for that star, others would demand an increase in their deals as well.[586] Consequently, faced with the pressure to increase the net salaries for players whilst also remaining within the parameters of the wage ceiling structure, the concept of IRCs became increasingly common.[587]

The creation of an IRC enables the club to pay a star a basic salary (which is subject to income tax and National Insurance in the normal way), as well as separately entering into an agreement to a payment for the player's image rights.[588] The structure would be the typical IRC structure where the star assigns his image rights to the IRC and enters into a contractual agreement with the club for payment to the IRC for the exploitation of the star's image rights by the club.[589] These payments are between two companies and are therefore not subject to income tax and Pay as You Earn tax, as it

581 R Haynes 'Footballers' Image Rights in the New Media Age' (2007) 7(4) *European Sport Management Quarterly* 364.
582 R Haynes 'Footballers' Image Rights in the New Media Age' (2007) 7(4) *European Sport Management Quarterly* 364.
583 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.
584 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.
585 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.
586 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.
587 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.
588 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.
589 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.

does not constitute a salary payment to a UK resident.[590] The IRC is also established in a tax haven, and the revenue generated would remain tax free until it is distributed by that company.[591] This enables clubs to reduce the star's income tax bill and the club's National Insurance contribution (as explained hereunder) whilst remaining within the club's wage ceiling.[592]

4.11 General Taxation in the UK

If an individual is both resident and domiciled in the UK, they will be taxed on their worldwide income and capital gains. For a non-resident, UK tax will only be applicable to his UK-sourced income and he will not generally be subject to capital gains tax, other than in respect of certain UK property companies or carried interest.[593] In the instance where the individual is a UK resident, but not domiciled (or deemed to be domiciled) in the UK, he can elect to pay tax on overseas investment income, capital gains and certain offshore earnings only to the extent that these are remitted to UK.[594] This is called the "remittance basis".[595] This is not discussed in detail as the sport star is considered to be both a tax resident and domiciled in the UK for the purposes of this dissertation.

Since April 2013, the UK implemented the statutory residence test (hereafter SRT) for individuals.[596] This introduced the "automatic residence tests" and the "sufficient tie" test. If a taxpayer does not meet any of these tests, they will be considered to be non-UK residents.

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590 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.

591 P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.

592 R Haynes 'Footballers' Image Rights in the New Media Age' (2007) 7(4) *European Sport Management Quarterly* 365 and C Coors 'Sports Image Rights in the UK: Countering tax evasion in the football industry' (2017) 8(1) *Global Sports Law and Taxation Reports* 30 and P Hackleton & H Julian 'Image is everything' (2010) 4262 *LexisNexis*.

593 PWC 'United Kingdom Individual – Taxes on personal income' published on 10 July 2020 https://taxsummaries.pwc.com/united-kingdom/individual/taxes-on-personal-income (Accessed on 15 November 2020).

594 Section 644 of Chapter 2 of the UK Income Tax Act 2007 read together with For a detailed discussion of the remittance basis of taxation in the UK visit PWC 'United Kingdom Individual – Taxes on personal income' published on 10 July 2020 https://taxsummaries.pwc.com/united-kingdom/individual/taxes-on-personal-income (Accessed on 15 November 2020).

595 Section 644 of Chapter 2 of the UK Income Tax Act 2007 read together with For a detailed discussion of the remittance basis of taxation in the UK visit PWC 'United Kingdom Individual – Taxes on personal income' published on 10 July 2020 https://taxsummaries.pwc.com/united-kingdom/individual/taxes-on-personal-income (Accessed on 15 November 2020).

596 Schedule 45 to the UK Finance Act 2013.

The “automatic UK tests” consist of four tests[597]:

1. If an individual spends at least 183 days in the UK in the year;
2. If the individual’s only home is in the UK for at least 91 days in the year;
3. If the individual is working full-time in the UK for a period of 365 days, and during that period, there are no significant breaks from UK work and all or part of the 365 period falls within the year and the full time work is on average 35 hours or more per week over the period; and
4. When an individual dies in a tax year when he was previously automatically resident for previous three tax years and where the individual had a home in the UK.

If an individual does not meet any of the “automatic UK tests”, he can still qualify as a resident if he meets the “sufficient ties” test. To meet this test, a number of factors are considered in conjunction with the number of days that the individual spends in the UK. The “ties” relate to the following:[598]

1. Location of family;
2. Availability of UK accommodation;
3. Extent of UK work;
4. UK presence in earlier tax years; and
5. Whether more time is spent in the UK than any other country/jurisdiction

Broadly speaking, the more ties an individual has the less days they need to spend in the UK before becoming a UK resident. There is a distinction between “arrivers” and “leavers”. Where an individual has been regarded as not being resident in the UK for the three previous UK tax years, such individual is an “arriver" and the “ties” to be considered are the following:[599]

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597 Schedule 45 to the UK Finance Act 2013 read together with Chapter 2 of the UK Income Tax Act 2007 read together with PWC ‘United Kingdom Individual – Taxes on personal income’ published on 10 July 2020 https://taxsummaries.pwc.com/united-kingdom/individual/taxes-on-personal-income (Accessed on 15 November 2020).

598 Schedule 45 to the UK Finance Act 2013 read together with Chapter 2 of the UK Income Tax Act 2007 read together with KPMG “UK – Income Tax” published on 31 January 2020 https://home.kpmg/xx/en/home/insights/2011/12/united-kingdom-income-tax.html (Accessed on 15 November 2020).

599 Schedule 45 to the UK Finance Act 2013 read together with Chapter 2 of the UK Income Tax Act 2007 read together with KPMG “UK – Income Tax” published on 31 January 2020 https://home.kpmg/xx/en/home/insights/2011/12/united-kingdom-income-tax.html (Accessed on 15 November 2020).

1. The UK resident family tie;
2. The accommodation tie;
3. The work tie; and
4. The 90-day tie.

Where an individual has been regarded as a UK resident in at least one of the three previous UK tax years, the following "ties" are considered[600]:

1. The UK resident family tie;
2. The accommodation tie;
3. The work tie;
4. The 90-day tie; and
5. The country/territory tie

The country/jurisdiction tie is when the individual is present in the UK at midnight on equal to or more days than in any other single country/jurisdiction.

As stated above, whether or not an individual is domiciled in the UK will have an impact on their UK tax status. In the UK, a person's domicile is usually the country in which they have their permanent home and typically follow that of their father.[601] For example, a person whose family come from South Africa and who continuous to have ties in South Africa will be considered as domiciled in South Africa if they are able to demonstrate to Her Majesty's Revenue and Customs (hereafter 'HMRC') when and in what circumstances they will return to South Africa.[602] Such person will then have "non-UK domicile" status and the tax laws applicable may be more favourable.[603]

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600 Schedule 45 to the UK Finance Act 2013 read together with Chapter 2 of the UK Income Tax Act 2007 read together with KPMG "UK – Income Tax" published on 31 January 2020 https://home.kpmg/xx/en/home/insights/2011/12/united-kingdom-income-tax.html (Accessed on 15 November 2020).

601 Section 644 of Chapter 2 of the UK Income Tax Act 2007 read together with PWC 'United Kingdom Individual – Taxes on personal income' published on 10 July 2020 https://taxsummaries.pwc.com/united-kingdom/individual/taxes-on-personal-income (Accessed on 15 November 2020).

602 Section 644 of Chapter 2 of the UK Income Tax Act 2007 read together with PWC 'United Kingdom Individual – Taxes on personal income' published on 10 July 2020 https://taxsummaries.pwc.com/united-kingdom/individual/taxes-on-personal-income (Accessed on 15 November 2020).

603 Section 644 of Chapter 2 of the UK Income Tax Act 2007 read together with PWC 'United Kingdom Individual – Taxes on personal income' published on 10 July 2020 https://taxsummaries.pwc.com/united-kingdom/individual/taxes-on-personal-income (Accessed on 15 November 2020).

Should the individual not have strong evidence to demonstrate that they do not intend to reside in the UK permanently, the HMRC are likely to content they have a domicile of choice in the UK.[604] Since April 2017, the UK has a deemed domiciled for all UK taxes once an individual has been UK resident for 15 out of the previous 20 tax years.[605]

A broad category of income that is earned is subject to income tax, including earned income from employment, dividends and interest, to name a few.[606] Income tax is charged based on different income bands. The band is as follows; if an individual receives a personal allowance up to £12 500, no tax is applicable. An individual who earns between £12 501 and £50 000 qualify for the basic tax rate of 20%. Income between £50 001 and £150 000 is subject to tax at a higher rate of 40% and for individuals who earn above £150 000, a rate of 45% is applicable, which is referred to as the additional-rate.[607]

The UK also have a PAYE system which is a HMRC system to collect income tax and national insurance contributions (hereafter "NIC") from employment.[608] NIC are a tax that is levied on salary earnings which are paid by both employees and employers.[609] The purpose of this tax is to help build the taxpayer's entitlement to certain state

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604 Section 644 of Chapter 2 of the UK Income Tax Act 2007 read together with PWC 'United Kingdom Individual – Taxes on personal income' published on 10 July 2020 https://taxsummaries.pwc.com/united-kingdom/individual/taxes-on-personal-income (Accessed on 15 November 2020).

605 Section 644 of Chapter 2 of the UK Income Tax Act 2007 read together with PWC 'United Kingdom Individual – Taxes on personal income' published on 10 July 2020 https://taxsummaries.pwc.com/united-kingdom/individual/taxes-on-personal-income (Accessed on 15 November 2020).

606 Section 3 of Chapter 1 of the UK Income Tax Act 2007 read together with KPMG "UK – Income Tax" published on 31 January 2020 https://home.kpmg/xx/en/home/insights/2011/12/united-kingdom-income-tax.html (Accessed on 15 November 2020).

607 Section 6 of Chapter 2 of the UK Income Tax Act 2007 read together with UK Government Website "PAYE and payroll for employers" https://www.gov.uk/paye-for-employers (Accessed on 15 November 2020).

608 UK Income Tax (Earnings and Pensions) Act 2003 read together with UK Government Website "PAYE and payroll for employers" https://www.gov.uk/paye-for-employers (Accessed on 15 November 2020).

609 UK Income Tax (Earnings and Pensions) Act 2003 read together with The money advice service 'How Income Tax, National Insurance and the Personal Allowance works' https://www.moneyadviceservice.org.uk/en/articles/income-tax-and-national-insurance#:~:text=National%20Insurance%20contributions%20are%20a,is%20not%20an%20annual%20tax.&text=12%25%20of%20your%20weekly%20earnings,%C2%A3962%20(2020%2D21) (Accessed on 15 November 2020).

benefits such as the State Pension and Maternity Allowance.[610] NIC does not apply annually as is the cases with income tax, but applies to each pay period, which might be monthly, weekly or any other period depending on the employment arrangement.[611] The NIC rate will depend on the income earned where the lowest amount that is subject to NIC in 2020/21 is £183 a week.[612] For employees, a rate of 12% of weekly earnings between £183 and £962 is applicable and an extra 2% for earnings above £962. The NIC is deducted together with income tax payable on an individual's salary in terms of the PAYE system before he receives his salary from his employer.[613] For employers, a rate of 13.8% is applicable for all earnings above £183 a week which will include the salary of the employee as well as any benefit in kind.[614]

As explained above, UK tax residents will also pay income tax on dividends. The UK has a tax-free dividend allowance in which tax need not be paid on dividend income for the first £2 000 dividend income received.[615] For dividend received above the tax-

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610 The UK National Insurance Contributions Act 2015 read together with The money advice service 'How Income Tax, National Insurance and the Personal Allowance works' https://www.moneyadviceservice.org.uk/en/articles/income-tax-and-national-insurance#:~:text=National%20Insurance%20contributions%20are%20a,is%20not%20an%20annual%20tax.&text=12%25%20of%20your%20weekly%20earnings,%C2%A3962%20(2020%2D21) (Accessed on 15 November 2020).

611 The UK National Insurance Contributions Act 2015 read together with Section 54 of the UK Income Tax (Earnings and Pensions) Act 2003 read together with The money advice service 'How Income Tax, National Insurance and the Personal Allowance works' https://www.moneyadviceservice.org.uk/en/articles/income-tax-and-national-insurance#:~:text=National%20Insurance%20contributions%20are%20a,is%20not%20an%20annual%20tax.&text=12%25%20of%20your%20weekly%20earnings,%C2%A3962%20(2020%2D21) (Accessed on 15 November 2020).

612 The UK National Insurance Contributions Act 2015 read together with The money advice service 'How Income Tax, National Insurance and the Personal Allowance works' https://www.moneyadviceservice.org.uk/en/articles/income-tax-and-national-insurance#:~:text=National%20Insurance%20contributions%20are%20a,is%20not%20an%20annual%20tax.&text=12%25%20of%20your%20weekly%20earnings,%C2%A3962%20(2020%2D21) (Accessed on 15 November 2020).

613 The UK National Insurance Contributions Act 2015 read together with The money advice service 'How Income Tax, National Insurance and the Personal Allowance works' https://www.moneyadviceservice.org.uk/en/articles/income-tax-and-national-insurance#:~:text=National%20Insurance%20contributions%20are%20a,is%20not%20an%20annual%20tax.&text=12%25%20of%20your%20weekly%20earnings,%C2%A3962%20(2020%2D21) (Accessed on 15 November 2020).

614 The UK National Insurance Contributions Act 2015 read together with PWC 'United Kingdom Individual – Taxes on personal income' published on 10 July 2020 https://taxsummaries.pwc.com/united-kingdom/individual/taxes-on-personal-income (Accessed on 15 November 2020).

615 Section 8 of Chapter 2 of the UK Income Tax Act 2007 read together with Which UK "Dividend tax" last updated April 2020 by D Richardson https://www.which.co.uk/money/tax/income-tax/income-tax-on-savings-and-investments/dividend-tax-ax8p28u7hyqt (Accessed on 15 November 2020).

free allowance, the rate applicable is based on the rate that the taxpayer pays on his other income, referred to as the "tax band" (as explained above). For the basic rate band, a dividend tax of 7.5% is applicable, for the higher rate, a rate of 32.5% and for the additional rate, a dividend tax of 38.1% is applicable.[616]

Previously, a UK resident could receive credit on foreign dividends earned. From April 2016, this is no longer applicable and foreign dividends and local dividends are subject to the same tax-free allowance and payable on the same dividend tax rates.[617]

4.12 Her Majesty's Revenue and Customs Guide on Employment Income: Payments for image rights and the Sports Club case

In 2015, it was reported that an agreement was reached between the UK tax authority, HMRC and UK sports clubs that allowed clubs to treat up to 20% of the salaries paid to players as a payment for the use of their image rights.[618] When queried, the HMRC denied agreeing to any such deal.[619] In 2017, the HMRC stated that they were investigating more than 100 football players over their use of "tax avoidance schemes".[620] During August 2017, the HMRC published an internal manual on employment income, providing some guidance on payments for image rights and the use of a company.[621] Internal manuals do not have the force of law and are available online to provide guidance to HMRC staff on how they interpret UK tax law and how taxpayers' affairs should be dealt with.[622]

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616 Section 8 of Chapter 2 of the UK Income Tax Act 2007 read together with Which UK "Dividend tax" last updated April 2020 by D Richardson https://www.which.co.uk/money/tax/income-tax/income-tax-on-savings-and-investments/dividend-tax-ax8p28u7hyqt (Accessed on 15 November 2020).

617 etc Tax 'UK Tax on Foreign Dividends – Rates & Reliefs' updated 11 June 2019 by A Wood https://www.etctax.co.uk/tax-on-foreign-dividends/ (Accessed on 15 November 2020).

618 K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 14.

619 K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 14.

620 K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 14.

621 HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

622 K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 14.

4.12.1 Sport Club Case[623]

This anonymised case dealt with the actions of an English football club (hereinafter referred to as the "Sport Club") in respect of two star players, Evelyn and Jocelyn (pseudonyms).[624] Both these stars had high profiles as existing international players even before joining the Sport Club on transfer from clubs outside the UK.[625] The stars both had pre-existing arrangements for the exploitation of their image rights though the use of an IRC.[626] The stars entered into promotional agreements with the IRC in terms of which they agreed to provide promotional services in return for payment.[627] When the stars took up employment with the Sports Club, both entered into an arrangement where the club would make payments, in addition to the remuneration payable to them in terms of their employment contract, to the IRCs that were licensed to exploit their image rights.[628] At the time, the Sports Club had not previously entered into such arrangements in relation to any other players.[629]

The case before the Special Commissioners was whether the payments made to the IRC constituted earnings by virtue of their employment, and should therefore be subject to tax on employment income, or if not, be taxed as a benefit in-kind (which is taxed as earnings from the employment).[630] The commission formulated a number of questions in order to address the issue before them. There are three questions that are most relevant to this dissertation which will be discussed briefly below.

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623 *Sport Club & Ors v HM Inspector of Taxes* (2000) Sp C 253 (hereafter 'Sport Club' case).

624 The club is the Arsenal Football Club and the players referred to are the Dutch international Denis Bergkamp and the England captain David Platt from Inter Milan and Sampdoria respectively.

625 Sport Club case headnote and HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

626 Sport Club case para 3 and HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

627 Sport Club case para 3 and HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

628 Sport Club case para 3 and HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

629 Sport Club case and HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

630 K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16.

1. Did the promotional agreements have independent values?[631]

The Commission held that the promotional agreements were indeed capable of having independent values and were genuine commercial agreements which the parties could seek to enforce.[632]

2. Were the promotional agreements a 'smokescreen' for additional remuneration?[633]

It was argued on behalf of Inland Revenue (the predecessors of HMRC) that the promotional agreements were entered into because the club had a wage ceiling (as explained above) and that the promotional agreements were a means of paying the stars sums, in addition to their salaries.[634] The Commission submitted that the payments made pursuant to those agreement were in reality "rewards" for the players in terms of the employment relationship and that the agreements were facades.[635] The Commission examined the contracts between the club and IRC and found that the club entered into the promotional agreement with the expectation that it would exploit the image rights of the star and make money from them.[636] They accordingly held that the promotional agreements were not a "smokescreen" for the payment of additional remuneration.[637]

3. Were the payments in terms of the agreements emoluments arising from the employment?[638]

Counsel for the Appellants argued that the payments received from the club in terms of the promotional agreement were not made as part of the reward for being an employee of the club.[639] The money was paid to the IRC because the company held the image rights of the sport star and it is the exploitation of these rights that were the

631 Sports Club case para 74 and K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16.
632 Sports Club case para 79 and 83 and K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16.
633 Sports Club case para 87 and K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16.
634 Sports Club case para 87.
635 Sports Club case para 87.
636 Sports Club case para 90 and 92.
637 Sports Club case para 89 and 91.
638 Sports Club case para 96 and K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16.
639 Sports Club case para 97.

source of the money.[640] The payments made in terms of the promotional agreements were not made to the star personally and such payments were not due to them and did not belong to them.[641] It is reiterated that these payments were not paid under any contract of employment with the club at all.[642] It was therefore argued that these payments in terms of the promotional contract did not amount to emoluments from the employment of the stars.[643] The commission found that those payments were made for promotional rights and consultancy services respectively and were consequently not made 'in reference to' the actual playing of football in terms of their employment relationship to the club.[644] These payments were not a reward paid by the club to the stars for their services, but were paid by the club for the promotional rights (i.e. image rights) and consultancy services respectively.[645] They consequently held that these payments were not emoluments from the employment of the stars.[646]

4.12.2 HMRC Guide

The HMRC provided long awaited guidance on image rights and published a guide on 16 August 2017.[647] The HMRC stated, with reference to the above Sport Club case, that the decision by the Special Commissioner, which was published in an anonymous form, were never appealed by the Inland Revenue, and that the case did not progress beyond the Special Commissioners and therefore regards the decision as informative rather than having created precedent.[648] HMRC will still consider whether such payments to an IRC should be regarded as income arising from an employment rather than a separate source of income.[649]

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640 Sports Club case para 97.
641 Sports Club case para 97.
642 Sports Club case para 97.
643 Sports Club case para 97.
644 Sports Club case para 100.
645 Sports Club case para 100.
646 Sports Club case para 100.
647 Guidance: 'Tax on payments for use of image rights" obtained from https://www.gov.uk/guidance/tax-on-payments-for-use-of-image-rights (accessed on 27 November 2020) read together with K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16 and Markel Tax 'Taxation of Image Rights' published on 16 April 2018 https://www.markeltax.co.uk/industry-news/https-www-markeltax-co-uk-industry-news-uk-interna (Accessed on 1 October 2020).
648 HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).
649 HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

The guide identifies that payment received by a sport star for the exploitation of his image rights can lead to three different tax consequences, namely:[650]

1. Where payment is made to a self-employed sport star, it could be taxable as professional income;
2. Where payment is made to a sport star for the duties of the star's employment, it must be taxed as remuneration, subject to tax deductions at the source and not as payments for the use of image rights;
3. Image rights payments made to a UK company will give rise to UK corporation tax on the profits of the company. Income then received by the individual from the company will be taxed according to the type of income received, for example dividends will be subject to dividend tax.

The Guide states that the HMRC is of the view that payments made to an IRC has the potential of being more than one type of payment and could attract different kinds of tax liabilities. They will seek to apply tax to each element of the payment in accordance with UK tax law. Should the payment meet the definition of a royalty, there will be an obligation on the payer to deduct withholding tax on royalties and, should this not be done, the HMRC will prosecute the taxpayer.[651] HMRC states that some of the intellectual property rights that form the image rights that are assigned to an IRC will meet the definition of intellectual property within Section 579(2) of Part 5 of the Income Tax (Trading and Other Income) (hereafter 'ITTOIA').[652] The taxpayer may be placed under an obligation to deduct withholding tax from any payments made that represent income tax under Part 15 of the Income Tax Act.[653] Chapter 6 of part 15 of the Income

650 K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16 and Markel Tax 'Taxation of Image Rights' published on 16 April 2018 https://www.markeltax.co.uk/industry-news/https-www-markeltax-co-uk-industry-news-uk-interna (Accessed on 1 October 2020).

651 K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16 and HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

652 Income Tax (Trading and Other Income) Act 2005 (hereafter 'ITTOIA'). Section 579(2) define 'intellectual property' as (a)any patent, trade mark, registered design, copyright, design right, performer's right or plant breeder's right, (b)any rights under the law of any part of the United Kingdom which are similar to rights within paragraph (a),(c)any rights under the law of any territory outside the United Kingdom which correspond or are similar to rights within paragraph (a), and (d)any idea, information or technique not protected by a right within paragraph (a), (b) or (c).

653 Income Tax Act 2007.

Tax Act regulates withholding tax of sums representing income tax from royalties within the scope of Section 578 of the ITTOIA. Each individual's circumstances will be considered in order to determine whether tax should be withheld.[654]

Where the payment is determined to constitute remuneration in terms of an employment contract, an obligation is placed on the club to deduct payroll taxes such as PAYE and NIC.[655]

HMRC argues that a football star is employed by a club to be a member of a team. Remuneration is paid to the star in terms of a contract of employment for the performance of the duties of employment. These duties may include promotional services as well as playing for the club.[656] They accept that it might be possible to split these duties in two (or more) contracts, but may still constitute one arrangement. HMRC requires that there must be a commercial justification for distinguishing between payments for performance of the duties of employment and payments for promotional services through an IRC.[657] This is explained by referring to the fact that image rights contracts are generally negotiated in parallel to a contract of employment. When the star renegotiates his employment contract it may result in a renegotiation of the image rights agreement which creates the impression that the total payments are considered by the employer to form part of an overall package.[658]

654 K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16 and Markel Tax 'Taxation of Image Rights' published on 16 April 2018 https://www.markeltax.co.uk/industry-news/https-www-markeltax-co-uk-industry-news-uk-interna (Accessed on 1 October 2020).

655 K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16 and HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

656 K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 17 and HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

657 K Offer 'Taxation of image rights' (2018) 1392 *Tax Journal* and K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16 and HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

From the Guide it is clear that HMRC regards commerciality as the main consideration and each case will be reviewed on its own facts rather than applying one accepted principle.[659]

4.13 Geovanni Case[660]

Hull City (football club) entered into an image rights agreement with Joniere Limited (the IRC), a company that is registered in the British Virgin Islands (a tax haven jurisdiction).[661] The star football player of the club, Geovanni Gomez, known as Geovanni, had assigned his image rights to the IRC.[662] The image rights agreement only covered non-UK image rights and it would appear that all UK image rights were covered by the employment contract with the club.[663] The scheme that was entered into by the star will be discussed below.

From December 2008 to July 2010, it was found that the club had paid a total of £440 800 to the IRC for exploiting UK image rights.[664] It was stated on behalf of the club that these payments were made in terms of the image rights contract and were separate from Geovanni's contract of employment with the club.[665] The argument on behalf of the HMRC was that these payments were remuneration and, therefore, subject to income tax and National Insurance Contributions.[666] There was very little documentary proof that could be provided on behalf of the star to prove the material aspects of the negotiations between the star and the club for both the employment

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659 K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16 and HMRC Internal Manual – Employment Income Manual EIM00733 available on https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733 (Accessed on 5 October 2020).

660 Hull City AFC (Tigers) Ltd v Revenue and Customs Commissioners [2019] UKFTT 227 (TC); [2019] S.F.T.D. 754; [2019] 3 WLUK 611 (FTT (Tax)) (hereafter the 'Geovanni Case').

661 Geovanni Case para 2 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 60.

662 Geovanni Case para 1 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 60.

663 Geovanni Case para 73 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 60.

664 Geovanni Case para 3 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 60.

665 Geovanni Case para 3 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 60.

666 Geovanni Case para 3 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 60.

contract and image rights agreement.[667] The contract of employment had the requisite standard clause referring to an agreement for image rights that was actually not signed for another four months. This was not a relevant factor to the court as the Premier League rules required such a clause and it was furthermore a standard playing contract.[668] At the time in the UK there was an accepted assumption that a player may receive payment for his image rights up to 25% of his basic salary.[669] The playing contract was extended in September 2010 and the image rights payments increased, despite the fact that the image rights agreement did not permit such increase. When questioned, the club informed HMRC that a variation of the image rights agreement was drafted and was still under negotiation, although in truth the star had already signed the agreement in March 2010.[670]

After a realistic view of the evidence, the court held that the payments were "emoluments as a reward for Geovanni's past, present or future services".[671] There is very little reference to UK tax legislation within the decision. The image rights agreement granted rights to the club to exploit Geovanni's non-UK image rights and is was therefore found that there was no 'sham' involved in this agreement.[672] The court concluded that the image rights had in actual fact no commercial value and, on a realistic view of the payments by reference to their substance and not their form, no conclusive evidence could be found to support the existence of an image rights agreement.[673] In paragraph 128 of the judgment, the Judge referred to a number of factors that he found relevant to the case, which provides a useful indication of what clubs, stars and their advisers should consider when reviewing their image rights contracts.[674] These factors are as follows:

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667 Geovanni Case para 55 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 60.

668 Geovanni Case para 67, 70 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 61.

669 Geovanni Case para 86 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 61.

670 Geovanni Case para 98 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 61.

671 Geovanni Case para 39 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 61.

672 Geovanni Case para 35, 132 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 61.

673 Geovanni Case para 126 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 61.

674 Geovanni Case para 128 and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 61.

1. The club did not have any clearly defined intention or plan to commercially exploit Geovanni's overseas image rights;

2. There is no reliable evidence as to how the club arrived at the annual image rights payment of £187,200 in 2008 and £230,116 in 2009;

3. The club did not obtain any valuation or opinion as to the value of Geovanni's overseas image rights in 2008 or 2009;

4. The club offered to increase the sum payable for Geovanni's overseas image rights without any contractual obligation to do so and as part of negotiations in 2009 intended to secure Geovanni's services as a footballer for a further year;

5. The club did not have the resources to exploit Geovanni's overseas image rights even if there was a market to do so;

6. The club did not have any real interest in commercially exploiting Geovanni's overseas image rights;

7. There was little if any prospect of the club exploiting those rights;

8. Geovanni's overseas image rights were never commercially exploited, before, during or after his period at the club;

9. The club did not satisfy the court that Geovanni's overseas image rights had any commercial value;

10. No-one at the club could reasonably have believed that the rights had any commercial value to the club; and

11. No-one at the club ever addressed their minds to whether it was realistic to consider that the club could commercially exploit Geovanni's overseas image rights.'

The court held that there was no evidence to suggest that the payments made to the IRC by the club were anything other than part of an overall amount to secure Geovanni's services as a football player and employee of the club.[675] The scheme that was entered into had the sole purpose of obtaining a tax benefit for the club to not be liable to pay NIC and for Geovanni to not be liable for income tax on the income received from the exploitation of his image rights. There was no other commercial purpose for the arrangement club. The appeal was therefore dismissed.[676]

4.14 Controlled Foreign Companies: UK

The UK already adopted its CFC rules in 1984, which was then entirely modified in 2012.[677] The UK incorporated its CFC rules before the EU adopted its own standards and did not initially adopt some of the standards imposed by the EU in the Anti-Tax Avoidance Directive. [678] As the country was expected to leave the EU in the first half of 2019, it was initially not necessary for them to adopt these standards. However, as they are still part of the EU it became mandatory for them to comply with the Anti-Tax Avoidance Directive. [679]

Under the UK rules, a CFC is any foreign company in which a UK resident or residents hold at least 25% interest directly or indirectly.[680] Unlike South African and Spanish CFC legislation, in the UK a foreign entity will only qualify as a CFC depending on a broad set of standards that have to be met. These standards are the following:[681]

1. Legal control – which is measured by the possession of shares or voting rights;

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675 Geovanni Case and K Offer 'Alonso and Geovanni: Image rights case comparison' (2020) 23 *Taxation Reports'* 61.

676 Geovanni Case para 133.

677 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

678 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

679 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

680 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

681 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

2. Economic control – which entails the entitlement that a person has to a majority of the proceeds or to the disposal of the shares of a company – for example where a UK and South African company operate a joint venture in Spain, the UK company controls 40% of the venture and the South African company controls the rest, the joint venture will be considered a CFC for UK purposes;

3. Accounting control – which is when the parent company undertakes the role for financial purposes under the accounting standard under British rules. A company is a CFC if the accounts of that foreign company are consolidated in the accounts of a UK company.

The aim of the CFC regime in the UK is to identify whether all or parts of the profits made by non-resident UK companies should be brought into charge to a UK resident.[682] The CFC regime operates by applying a series of charge "gateways" to the various types of profits that are not exempt.[683] The gateways are a series of tests that work as filters for profits in order to determine if they must be taxed.[684] The application of each filter works in sequence and there are different filters that will limit or eliminate the application of CFC rules.[685]

Notably, the CFC regime in the UK is currently only applicable to a chargeable company, which is a UK resident company that has sufficient interest in a CFC and enough chargeable profits to be taxed.[686] The UK CFC rules address both active and

682 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

683 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

684 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

685 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

686 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

passive income.[687] The UK has agreed to modify its CFC rules according to the Anti-Tax Avoidance Directive standard, up until such date that Brexit arrives, where after it may possibly be amended again. It is clear that the OECD BEPS recommendations was not considered by the UK government in the current form of its CFC regime because the scope of the CFC rules is limited to UK resident companies, therefore not being as broad as the OECD BEPS recommends.[688] The first modification will therefore be to expand the scope to include interest held by non-resident associations or related parties.[689]

4.15 Conclusion – Part C

UK, similarly to Spain, has a big football following which also meant that star football players would sign playing contracts with UK clubs. The competition to procure these football stars lead to a number of clubs establishing wage structures that included a wage ceiling which meant that the clubs were reluctant to agree to deals in excess of the maximum wages. It had soon become a challenge for clubs to adhere to the wage structures when competing with one another in the race to sign top football stars which lead to the creation of an IRC to enable the clubs to pay the star a separate income on top of his basic salary. This structure would not only benefit the sport star but also the club as the club had managed to split the star's remuneration into two separate payments, the one on which the club must pay National Insurance contribution together with PAYE and the other where the payment was merely a royalty payment to the IRC.

In the Sports Club Case[690] examined an IRC scheme and found that such scheme was not a "smokescreen" for the payment of additional remuneration. In 2007 the HMRC published a Guide in which it did not regard the Sports Club case as precedent

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687 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

688 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

689 Tax Foundation 'How Controlled Foreign Corporation Rules Look Around the Word: United Kingdom' published on 15 July 2019 by D Bunn https://taxfoundation.org/uk-cfc-rules/ (Accessed on 15 November 2020).

690 *Sport Club & Ors v HM Inspector of Taxes* (2000) Sp C 253 as discussed under paragraph 4.12.1 above.

and rather concluded that payments by the club to the IRC as income from an employment relationship as opposed to a separate source of income. The Guide acknowledges that payments that are made to an IRC can take the form of more than one type of payment (it is not always the club who pays for the exploitation of image rights) and the HMRC will seek to apply tax to each element of the payment in accordance to UK tax law. This Guide is more complete than SARS' Guide on the Taxation of Professional Sports Clubs and Players and it is the opinion of this dissertation that a more detailed Guide that specifically consider the income derived from the exploitation of image rights are required in South Africa.

The case study of Geovani[691] gave clarity to these schemes where the club make the payment to the IRC and concluded that such scheme is only entered into in order to obtain a tax benefit for the club to not be liable to NIC and for the player to not be liable for income tax on the income received from the exploitation of his image rights. Once again (as is the case with South African GAAR and the two case studies in Spain) it is the lack of commercial purpose that the courts have regard to in order to come to the conclusion that such a scheme is nothing other than a tax avoidance or evasion scheme.

The current CFC legislation in the UK is according to this author unsatisfying as it will not, in its current format, apply to the typical IRC structure that this dissertation considers.

4.16 Overall conclusion

Through the work of the OECD and the cooperation of various jurisdictions it is clear that there are a global war against cross border tax avoidance and evasion. The Standards such as EOIR[692], Standard for Automatic Exchange of Financial Information and CRS[693] are all currently assisting in eroding the anonymity that previously existed between various jurisdictions. By enabling tax authorities in different jurisdictions to obtain information of entities incorporated in other jurisdictions, especially in tax

691 Hull City AFC (Tigers) Ltd v Revenue and Customs Commissioners [2019] UKFTT 227 (TC); [2019] S.F.T.D. 754; [2019] 3 WLUK 611 (FTT (Tax)) as discussed under paragraph 4.13 above.

692 Exchange of Information on Request as discussed under paragraph 4.1 above.

693 Common Reporting Standard as discussed under paragraph 4.1 above.

havens, it will become more difficult for tax minimisation schemes such as the creation of an IRC to be entered into. In all the case studies above the courts was able to piece together all the elements of the schemes and this could only be done because both Spain and the UK had access to information such as where the IRC was incorporated and who was the shareholders in these entities.

It is clear from the cases in both Spain and the UK that courts consider the substance rather than the form of an image rights agreement and ultimately image rights payments that are received. The Spanish tax authorities viewed the Messi IRC structure as nothing other than an elaborate scheme with the purpose to defraud the tax authorities. The authorities accused the IRC created by Ronaldo to be a mere shell company with no business activity that was only created to receive passive income from the exploitation of Ronaldo's image rights. In the UK the HMRC requires that each image rights agreement must make commercially sense and that evidence must be adduced by the club and the player in order to satisfy them as to why such payments must be separated from the star's remuneration in terms of the employment contract.

Spain has specific anti-avoidance legislation that regulate the income from the exploitation of image rights and the UK has a specific Guide that provides a detailed overview of how income from the exploitation of image rights should be perceived. It is possible that these specific legislation and guidance exist because football stars who earn millions from their image rights is a common denominator in both these jurisdictions. It is much more beneficial to have specific legislation and guidance on the topic of image rights income and it is my opinion that it was due to these specific legislation and guidance that the courts in the case studies above was able to adequately punish the sport stars who entered into IRC schemes.

In the 2019/20 tax year it has become apparent that the HMRC is eager to address IRC structures and are increasingly concerned about the potential tax loopholes it creates.[694] It is reported that the HMRC is investigating 246 individual football players,

694 P MacInnes 'Tax affairs of 246 footballers being investigated by HMRC in 2019-20' published on 10 August 2020 on the Guardian https://www.theguardian.com/football/2020/aug/10/tax-

which number increased from 87 in 2018.[695] This appears to be a similar trend to Spain where there has been an increase in the number of investigations into the tax affairs of football stars. What is evident in both jurisdictions are that these schemes are generally not accepted by the respective tax authorities and from the case law it would appear that the tax laws available to these jurisdictions enable the authorities to disregard the schemes.

In Chapter 5 a conclusion will be made on whether South Africa can learn any lessons from the aforementioned jurisdictions.

affairs-of-246-footballers-being-investigated-by-hmrc-in-2019-20 (Accessed on 9 October 2020).

695 P MacInnes 'Tax affairs of 246 footballers being investigated by HMRC in 2019-20' published on 10 August 2020 on the Guardian https://www.theguardian.com/football/2020/aug/10/tax-affairs-of-246-footballers-being-investigated-by-hmrc-in-2019-20 (Accessed on 9 October 2020).

Chapter 5: Conclusion

5.1 The Status of Image Rights in South Africa

Currently, a South African sport star does not hold a specifically recognised proprietary interest or property rights in his likeness or *persona* and it can therefore be concluded that the current South African legislation does not recognise image rights as a stand-alone rights in its own nature.[696] Due to the aforementioned, the existing laws pertaining to Intellectual Property are utilised to understand how a sport star's image rights may be protected and furthermore how such image rights are commercially exploited in order to ultimately study the tax consequences that are attached to the monies received from the exploitation of such right. The two intellectual property laws that was examined in Chapter 2 are the Copyrights Act and the Trade Marks Act.

The Copyrights Act does not provide a definition for "image rights". There are nine specific classes of work in which copyright can subsist, namely: literary works; musical works; artistic works; cinematograph films; sound recordings; broadcasts; programme-carrying signals; published editions and computer programs.[697] Image rights does not fall into any one of these categories. Even if image rights were to fall within the ambit of one of the nine classes of work, such work would have to constitute "original" work. Such original work would have to be reduced to a material form and the author of the work must be a qualified person in terms of the Copyrights Act.

I considered the example of Lionel Messi's name and applied it to the requirements in the Copyrights Act and found that image rights will not be protected under the Copyrights Act. This would in any event be highly impractical as, for example, should Messi's name be protected under the Copyrights Act, for every new news article written about the sport star, published almost daily, the author of the article would have to obtain Messi's permission prior to publishing his name otherwise it will be an infringement of Messi's copy right.

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696 S Bosse 'Protecting the Image Rights of our Sport Stars' (2008) https://www.bosse-associates.co.za/protecting-the-image-rights-of-our-sport-stars/ (Accessed on 16 April 2018) as discussed in paragraph 1.1 in Chapter 1 above.

697 Section 2 (1) of the Copyright Act 98 of 1978.

A trade mark in terms of the Trade Marks Act however generally includes brand names and has in practice been utilised by various famous sport stars. A trade mark is utilised in order to distinguish one person's brand from another and must therefore be inherently distinguishable and not general or something that may be confused with another mark. The possibility of a trade mark in sport include, *inter alia*, a sport star's name, catch phrase, nicknames and also his image rights. The South African star springbok player Naas Botha also registered his name as a trade mark.

In the context of sports law, image rights can best be described as another source of income for sport stars. This is owed to the fact that people are fixated with sport stars and the brands that they associate themselves with. This in return encourages commercial brands to enter into contracts with these stars and paying them large sums of money in the form of sponsorships and endorsements in order to associate their brand with these stars. The commercialisation of a sport star's image rights is based on a reciprocal relationship where the advertiser enhances the reputation of their brand by associating the product or goods with the sports star, and in return the sports star receives compensation from the advertiser for the use and exploitation of his image rights.[698] Social media takes centre stage of modern day endorsement deals and the more the star's Instagram followers are engaged in the content that the star post the more valuable such endorsement becomes. [699] Currently, Ronaldo is the sport star with the most Instagram followers in the world, which consequently attracts very lucrative endorsement deals.[700]

As sport stars are generally associated with a club or franchise (apart from individual sport such as golf and tennis), there is also a symbiotic relationship between a sport star and the club for whom he plays. On the one hand the club builds their repertoire by having famous stars play for them and thereby attracting large sponsorship deals for the entire club. On the other hand, the club already has a founded reputation and a large fan base and it has therefore been founded that football players who play for

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698 S Bosse 'Protecting the Image Rights of our Sport Stars' (2008) https://www.bosse-associates.co.za/protecting-the-image-rights-of-our-sport-stars/ (Accessed on 16 April 2018 and 23 August 2020).

699 B Enoch 'How Athletes Get Endorsements and Sponsorships' posted on 9 March 2020 https://opendorse.com/blog/how-athletes-get-endorsements-and-sponsorships/ (Accessed on 23 August 2020).

700 As at 25 October 2020 Cristiano Ronaldo have 241 million Instagram followers.

big and famous clubs are more popular and consequently have an increased image rights value. It is due to this type of relationship that is has been practice for football clubs to own a sport star's image rights when such star signs a playing contract with the club. Image rights are typically contained in a section of the employment contract with the club (or in an ancillary commercial agreement thereto) which contains all the provisions that stipulate the licensing of the image rights of the sport star and who specifically owns this right and who will receive the remuneration for the exploitation of these rights. More famous sport stars have better negotiation powers and they typically negotiate with the club to such an extent that they themselves own their image rights, without having to cede such right to the club as part of the employment contract. A few examples of sport stars who have exclusive control of their image rights includes Cristiano Ronaldo, Siya Kollisi and Pieter-Steph du Toit.

5.2 South African Tax Regulations of Image Rights Payments

There are different tax implications attached to two different scenario's, the first being when income is received directly by the sport star for the exploitation of his image rights and the second is where the star entered into an IRC scheme whereby he assigns his image rights to an IRC that is incorporated in a tax haven and only receive income indirectly for the exploitation of his image rights in the form of a foreign dividend.

5.2.1 Scenario One – Sport star received the income directly

The Income Tax Act will regulate all taxes that are attached to the receipt of income from a third party for the exploitation of the star's image rights. In this dissertation the star qualifies as a South African tax resident either because he met the physical presence test in terms of Section 1(a)(ii) of the Income Tax Act[701] or the ordinary residence test in terms of Section 1(a)(i) of the Income Tax Act.[702]

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701 As discussed under paragraph 3.2.1 of Chapter 3 above this is when a person is present in South Africa for a period exceeding 91 days in aggregate during the year of assessment and during each five years of assessment preceding the current year of assessment and for a period exceeding 915 days in aggregate during the five years of assessment preceding the current year of assessment.

702 As discussed under paragraph 3.2.1 of Chapter 3 above this is in essence where the taxpayer considers his "real home" to be.

In Chapter 3, South African sport star “A”, is used as an example whereby he registered his image rights as a trade mark in terms of the Trade Marks Act. He has exclusive control over his image rights. He then enters into an image rights agreement with Montblanc whom exploits his image rights by associating their brand with A’s trade mark, in exchange for payment.

The monies that are received by A for the exploitation of his image rights will be revenue in nature and not capital in nature. The reason for this is because the image rights which has been registered as a trade mark is the “capital” (i.e. tree) and the payment made by the third party for the exploitation thereof is the “income” (i.e. fruit) that the tree produces. This is the simple “fruit versus tree” analogy.[703]

As mentioned under paragraph 5.1 above, image rights are typically contained in the employment contract that the star enters into with the club or franchise. This section will stipulate whether payments that are made by either the club or a third party will constitute as payment for services rendered to the club, therefore qualifying as remuneration and subject to pay as you earn tax, or whether this will be a separate source of income for the star and therefore still forming part of his gross income, but not being subject to pay as you earn withholding tax.

It is concluded that in terms of the Income Tax Act, the monies received directly by A from Mont Blanc will constitute income which will form part of the star’s gross income as defined in Section 1 of the Income Tax Act. In terms of South Africa’s progressive rate structure and the highest rate for an individual is 45%. For the purpose of this dissertation it is accepted that the highest rate will be applicable and the income from AB’s image rights will therefore be subject to 45% tax. It is because of this high rate of tax that will be applicable that stars enter into the minimisation scheme of creating an IRC.

5.2.2 Scenario Two – the IRC scheme

A very basic depiction of an IRC can be found in figure one in Chapter 2. This in essence entails a four step tax-avoidance structure:

703 *Visser v CIR* SATC 271 para 276 as discussed under paragraph 3.2.3.2 in Chapter 3 above.

1. The star assigns his image rights to the IRC (incorporated in a low tax jurisdiction) in which he holds shares;
2. This parties enter into image rights contracts with the IRC for the exploitation of the star's image rights;
3. The third parties pay the IRC directly for the exploitation of the star's image rights; and
4. The IRC declares and pay the star a foreign dividend.

The aforementioned is a very simplified structure of what is entered into in practice. Figures 2 and 3 are examples of how complex these IRC structures can become in practice in order to build a "wall" between the sport star and the income received from the exploitation of his image rights.

Should A assign his image rights to an IRC he will dispose of an asset in terms of Paragraph 11 of the Eight Schedule of the Income Tax Act. A will be liable for capital gains tax at the inclusion rate of 40% should there be a capital gain from the disposal. As A will hold the majority shares in the IRC, the IRC and A will be regarded as "connected persons" and the value of the image rights will be market value as contemplated in terms of paragraph 38 of the Eight Schedule.

The IRC are registered in a tax haven and will be regarded as a "foreign company" only if the key strategic and management decisions are taken in the foreign jurisdiction. The star will therefore have to ensure that such decisions are not taken within the Republic of South Africa in order to ensure that the company continues to be classified as a foreign company.

It is accepted for the purposes of this dissertation that a tax benefit will be derived in terms of this scheme and that the IRC will be subject to low or no corporate tax in the tax haven jurisdiction.

Third parties will enter into image rights agreements with the IRC and pay the IRC royalty payments (this is because the image rights are registered as a trade mark before it is assigned to the IRC and such payments will only be passive income that

are subject to royalties withholding tax). The IRC, having virtually no expenses, will make a profit from the royalty income and will declare and pay dividends to A. Because the IRC is a foreign company, the dividend received by A is a foreign dividend as defined in Section 1 of the Income Tax Act. Section 10B(2)(a) of the Income Tax provides for a "participation exemption" which exempts from a resident's gross income a foreign dividend received from a company in which such resident holds at least 10 percent of the total equity shares and voting rights. It is assumed for purposes of this dissertation that A will qualify for this participation exemption and he will therefore not be subject to dividends tax. This, in comparison to the 45% income tax that are levied when A receives the image rights payments directly, clearly constitute a tax benefit for the star.

5.3 South African Anti-Avoidance Regulations of IRC Schemes

The scheme entered into in terms of scenario two is a result of careful tax planning. In order to ascertain whether South African regulations would regard this scheme permissible or impermissible avoidance, the general legislation as provided for in terms of the General Anti-avoidance Regulations in terms of Sections 80A to 80L of the Income Tax Act is first examined.

In Chapter 3 the provisions of GAAR was applied to the basic IRC scheme and it is found that the provisions are broad enough to conclude that the creation of an IRC is an arrangement which result in a tax benefit for the star. The provisions of GAAR further inquire as to whether such arrangement is abnormal or *bona fide* for business purpose and whether it lacks commercial sense.

I conclude that the only reason for the star to enter into a scheme wherein he assigns his image rights to an IRC is solely to create a "wall" between himself and the income that he derives from the exploitation of his image rights. This arrangement is abnormal, because the star has the ability to negotiate with third parties for the exploitation of his image rights whilst he himself is still the owner of these rights. The IRC that is established by the star will merely be a shell company with one or two employees and the only business activity of the company will be to receive the passive income in the form of royalty payments. The IRC will lack commercial substance. The author hereof

concludes that it is satisfactory that the general anti-avoidance provisions in South Africa will be broad enough to allow the tax authorities to utilise in order to prosecute sport star who enter into such schemes.

The courts will also be able to utilise the well-known doctrine of "substance over form" as extended by *CSARS v NWK.*[704] The court will inquire into the real substance and purpose of the IRC scheme and question the commercial sense of the transactions that take place. For the reasons above, it is concluded that the court will most likely find that the creation of an IRC is a simulation transaction with the sole purpose of avoiding tax.

It is found that the IRC scheme will be prosecuted by the tax authorities and that the courts will very likely concluded that it is an impermissible anti-avoidance arrangement. The provisions of Section 80B of the Income Tax Act will then set out the punitive measures available to the Commissioner. Should it be found by the court that the star reduced his tax liability by structuring his affairs in such a manner that he committed fraud against the *fiscus*, the star will be guilty of tax evasion. The penalties available to the Commissioner in this regard is found in the Tax Administration Act.

In addition to the general anti-avoidance regulations, South Africa also have specific anti-avoidance legislation that will apply to the creation of an IRC. These provisions are referred to as CFC legislation.[705] CFC legislation is created in line with international standards referred to as BEPS[706] which is standards set out for jurisdictions to implement into their domestic law in order to prevent the erosion of the tax base of a jurisdiction through the shifting of profit from the jurisdiction where such profit is actually received to low tax jurisdictions. The South African CFC legislation is found in Section 9D of the Income Tax Act. These provisions are very technical and complex in nature. What it essential entails is that a foreign company will qualify as a CFC when a resident, or residents in conjunction with one another, holds 50 per cent of either the total participation rights or in absence thereof, voting rights, of the company.

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704 *CSARS v NWK Ltd (2011)* 2 All SA 347 (SCA) as discussed under paragraph 3.4.4. in Chapter 3 above.

705 Controlled Foreign Company as discussed under paragraph 3.4.5.1 in Chapter 3 above.

706 Base Erosion and Profit Shifting as discussed under paragraph 3.4.5.1 in Chapter 3 above.

I accept that the sport star, i.e. A in our example, will hold more than 50 per cent of the shares in the IRC (as the sole purpose of the IRC is to indirectly receive income from the exploitation of his image rights in the form of a dividend) and that the IRC will therefore qualify as a CFC. Section 9D(2A)(a)(i) of the Income Tax Act will apply and essentially require that the net income of the CFC form part of AB's gross income in the ration that he holds a percentage participation right in the CFC.

It is concluded that it is once again a satisfactory position that South Africa has specific legislation that will apply to an IRC scheme. However, it is unfortunate that the provisions contained in the South African CFC legislation is overly complex and that there might be a difficulty to adequately apply these provisions to an IRC for that reason.

In Chapter 3 there was also a discussion on the SARS Guide on the Taxation of Professional Sports Clubs and Players.[707] This Guide unfortunately only discussed image rights briefly and relied mainly on the case of ITC 1735 64 SATC[708] which is a 2001 case that relied on legislation that has since been repealed. The author made the conclusion in Chapter 3 that some of the findings in the Guide (such as the fact that payments made to the sport star for the exploitation of image rights will be remuneration in nature and furthermore that it is not possible for the sport star to assign his image rights) to be inaccurate. It is the opinion of this author that this Guide is a very unsatisfactory Guide. It is furthermore concluded by this author that it is unsatisfactory that there is no specific legislation that specifically deal with the taxation of image rights.

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707 SARS *Guide on the Taxation of Professional Sports Clubs and Players* (2018) https://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-Gen-G08%20-%20Guide%20on%20the%20Taxation%20of%20Professional%20Sports%20Clubs%20and%20Players.pdf (Accessed on 10 September 2018) as discussed under paragraph 3.3.1 of Chapter 3 above.

708 As discussed under paragraph 3.2.3.3 in Chapter 3 above.

5.4 How do other Jurisdictions Regulate IRC Schemes

5.4.1 Global tax avoidable regulations

Over the past few years there has been a global war on offshore tax avoidance and evasion. The key feature of the improvement against this type of tax behaviour is the shift towards tax transparency. The OECD has proposed various standards in which jurisdictions are encouraged to exchange information regarding the true owner of assets and entities either upon request (EOIR)[709] or automatically in terms of the CRS.[710]

First world countries such as UK has embraced these Standards and found that there have been large improvements in offshore tax compliance as a result thereof. it is satisfactory to see that South Africa has always adhered to the Standards set forth by the OECD and this will ultimately make it possible for tax authorities to obtain the necessary information regarding the true owners of the IRCs and where such IRCs are incorporated, which will make it possible for the Commissioner to prosecute the sport stars, being the true recipients of the image rights income.

5.4.2 Spain

What makes Spain unique is that image rights are not only recognised in terms of Spanish law (other than in South Africa where it is not yet recognised), but it also enjoys Constitutional protection.

Spain has specific regulations known as the 85%/15% Rule that is contained in the Spanish Income Tax Act which deals specifically with the income derived from image rights. They also have CFC legislation contained in their Income Tax Act as is the case with South Africa, however the Spanish CFC legislation is not as overly complicated as the ones in the South African Income Tax Act.

In Chapter 4 it is illustrated that the Spanish tax authorities are inclined to prosecute sport stars who enter into IRC schemes and that the Spanish Penal Code is sufficiently drafted to apply to an IRC scheme and to impose hefty fines, even prison sentences,

709 Exchange of information on request as discussed under paragraph 4.1 in Chapter 4 above.
710 Common Reporting Standard as discussed under paragraph 4.1 in Chapter 4 above.

on the taxpayers who enter into such schemes. The Spanish tax authorities view IRC as merely shell companies that lacks business purpose (i.e. commercial substance).

5.4.3 UK

In the UK the creation of IRCs seems to have come into existence historically not only for the benefit of the sport star but also for the benefit of the clubs.

Over the years UK has seen numerous such schemes which have been tested in their courts more regularly than in South Africa. The HMRC published a Guide in 2017[711] which gave long awaited Guidance on the taxation of Image Rights. This Guide is a more complete Guide compared to the one that SARS published in South Africa.

The Geovani case in the UK examined the IRC scheme in detail and concluded that such schemes lacks commercial substance and that it was created with the sole purpose to obtain a tax benefit.

The CFC legislation that are currently in place in the UK is not up to the OECD standard and will currently not apply to an IRC scheme, which is unsatisfactory.

5.5 Lessons for South Africa from other Jurisdictions

It is clear from both Spain and the UK that the courts will consider the substance rather than the form of an image rights agreement and the payments made in terms thereof. The main inquiry by the courts will be whether such scheme (the creation of an IRC) has any commercial substance. This is in line with the well-known South African doctrine of substance over form. The general anti-avoidance regulations contained in GAAR also entail an inquiry into the commercial substance of an arrangement. It is therefore concluded that a South African court will most likely also come to the conclusion that the creation of an IRC will lack commercial substance, as has been

711 Guidance: 'Tax on payments for use of image rights" obtained from https://www.gov.uk/guidance/tax-on-payments-for-use-of-image-rights (accessed on 27 November 2020) read together with K Offer 'UK development in the taxation of image rights' (2017) 8 *Global Sports Law & Taxation Reports'* 16 and Markel Tax 'Taxation of Image Rights' published on 16 April 2018 https://www.markeltax.co.uk/industry-news/https-www-markeltax-co-uk-industry-news-uk-interna (Accessed on 1 October 2020) as discussed under paragraph 4.12.2 of Chapter 4 above.

the conclusion in the case studies in both Spain and the UK. This is a satisfying conclusion.

Where South Africa does seem to be short is in specific legislation that deal with the receipt of income from image rights (such as the 85%/15% Rule in Spain) and an adequate Guidance from SARS that deals in detail how SARS considers image rights income to be classified and what taxes are attached thereto (such as the Guide in the UK). It is concluded that South Africa can enact more specific legislation which will enable the Commissioner to prosecute a sport star who enters into an IRC scheme more easily and with greater certainty as to which laws are at their proposal. This in return will also serve as a Guidance to sport stars on how to not structure the tax affairs of this source of income.

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Annexure G

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Declaration of originality

This document must be signed and submitted with every essay, report, project, assignment, mini-dissertation, dissertation and/or thesis

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