

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

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## Abstract

*Sport undeniably plays a major role in society today. Over the years, it has developed into a free-standing industry and its players have become increasingly valuable and earn income both on and off the field. This article addresses the income generated by sport stars off the field of play through the exploitation of their 'image rights'. The use of someone's image rights can be explained as the practice of appropriating someone's personality. In modern society, people have become transfixed by sport stars. This has led to the image rights of individual sport stars such as Lionel Messi and Cristiano Ronaldo to become commodities exploited by their clubs and other third parties to enhance brand images and promote the sale of products.<sup>1</sup> This use of the image rights of celebrities generates a whole new source of income for these sport stars. Due to the relatively high amounts of income received for the use of a sport star's image, these stars may be tempted to enter into creative schemes in an attempt to reduce high taxes levied against these streams of income. The practice of the commercial exploitation of a sport star's image rights is a relatively new*

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1 R Cloete 'The taxation of image rights: A comparative analysis' (2012) 45 *De Jure* at 556; S Cornelius 'Image rights in South Africa' (2008) 3(4) *International Sports Law Journal* at 71.

development in South Africa and is not yet recognised to the same extent as in other jurisdictions, such as the UK and Spain.<sup>2</sup> This article examines the existing South African sport, intellectual property, and tax laws governing image rights and specifically analyses whether South Africa is sufficiently equipped, under tax legislation, to address these minimisation schemes aimed at reducing the tax liability arising from a South African sport star's image rights.

## 1 Introduction

Cloete defines the term 'image rights' as:

[T]he 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.<sup>3</sup>

Lionel Messi and Cristiano Ronaldo are examples of world-famous sport stars who earn large sums of money for the exploitation of their image rights to promote brands.<sup>4</sup> It, therefore, comes as no surprise that these stars have been advised to structure the receipt of income in relation to the exploitation of their image rights to minimise the tax liability thereof.

Both Messi and Ronaldo have used 'image rights companies' ('IRCs') to manage their image rights and reduce their tax liability.<sup>5</sup> In addition, in a renowned 2006 United Kingdom ('UK') court case, tennis star Andre Agassi was involved in a legal dispute over the taxation of payments relating to his image rights.<sup>6</sup>

2 M Louw 'Suggestions for the protection of star athletes and other famous persons against unauthorised celebrity merchandising in South African law' (2007) 19 *South African Mercantile Law Journal* at 282.

3 R Cloete (ed) *Introduction to sports law in South Africa* (2005) at 176.

4 *Messi Cuccittini v EUIPO* (T-554/14) EU:T:2018:230; [2018] 4 WLUK 470 (GC) and Supreme Court Criminal Chamber 1729/2016 Judgment (translated to English) Ronaldo cases [https://english.elpais.com/elpais/2018/07/26/inenglish/1532613639\\_389065.html](https://english.elpais.com/elpais/2018/07/26/inenglish/1532613639_389065.html).

5 M Mccann 'Ronaldo's tax fraud charges, the Beckham law and how his case compares to Messi, Neymar' 15 June 2017 <https://www.si.com/planet-futbol/2017/06/15/cristiano-ronaldo-tax-fraud-spain-beckham-law-real-madrid-messi-nyemar> (accessed 5 March 2019); R Wood 'Tax lessons from soccer's Messi & Ronaldo tax evasion cases' 16 June 2017 <https://www.forbes.com/sites/robertwood/2017/06/16/tax-lessons-from-soccers-messi-ronaldo-tax-evasion-cases/#1c8f85856ff4> (accessed 1 March 2018); S Burgen 'Cristiano Ronaldo denies €14.7m tax evasion in Madrid court' 31 July 2017 <https://www.theguardian.com/football/2017/jul/31/cristiano-ronaldo-denies-tax-evasion-madrid-court> (accessed 1 March 2018); AFP 'Ronaldo appears in court over tax evasion claims' 31 July 2017 <https://www.timeslive.co.za/sport/soccer/2017-07-31-ronaldo-appears-in-court-over-tax-evasion-claims/> (accessed 16 February 2018); Sport Staff 'Cristiano Ronaldo claims tax investigations are only because 'he's Cristiano Ronaldo' 1 August 2017 <http://www.independent.co.uk/sport/football/euro-pean/cristiano-ronaldo-tax-investigation-case-prison-jail-real-madrid-a7870516.html> (accessed 1 March 2018).

6 *Agassi v Robinson (Her Majesty's Inspector of Taxes)* [2006] UKHL 23.

Under these minimisation schemes, all income derived from the licensing and use of the image rights of the sport personality is received by the IRC.<sup>7</sup> For tax purposes, these IRCs are generally registered in so-called low-tax jurisdictions where they can secure the most favourable tax treatment.<sup>8</sup> Both Messi<sup>9</sup> and Ronaldo<sup>10</sup> have faced legal problems in recent years for using IRCs to avoid paying income tax.

This article examines South Africa's current legal framework regarding the taxation of image rights, and analyses whether it adequately addresses minimalisation schemes involving the taxation of income arising from professional sport stars' image rights. A brief comparison is drawn with tax legislation in Spain and the UK to establish whether South Africa is positioned to address such schemes when compared to its foreign counterparts.

## 2 The status of image rights in South Africa

### 2.1 Sports law

In the context of sports law, image rights can best be described as an additional source of income for sport stars.<sup>11</sup> The commercialisation of a sport star's image rights is based on a reciprocal relationship where the advertiser promotes the reputation of its brand by associating the product with the sport star and, in return, the sport star receives compensation from the advertiser for the use and exploitation of his or her image rights.<sup>12</sup> Social media takes centre stage in modern-day endorsement deals and the more the star's social

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

8 As above.

9 Messi was convicted of tax fraud in 2016 for defaulting on tax payments for his image rights on three occasions between 2007 and 2009. He diverted his image right monies to offshore companies in Belize and Uruguay, which then led to direct tax evasion. See Heimo Grup 14 'Explaining Lionel Messi's problems with the Spanish Tax Agency' 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).

10 Messi Cuccittini (n 4).

11 Louw (n 2) 278.

12 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 16 April 2018 & 23 August 2020).

media followers are engaged in the content that the star posts, the more valuable the endorsement becomes.<sup>13</sup>

As sport stars are generally associated with a club or franchise – apart from individual sports such as golf and tennis – there is also a symbiotic relationship between a sport star and the club for whom he or she plays.<sup>14</sup> On the one hand, the club builds its reputation by having famous stars play for it and thereby attracts large sponsorship deals.<sup>15</sup> On the other hand, the club may already have an established reputation and a large fan base. In this regard, it has been found that football players who play for big and famous clubs are more popular and consequently their image rights are valued higher.<sup>16</sup> For this reason, the practice has been established for football clubs to own a sport star's image rights when he or she signs up to play for them.<sup>17</sup>

A sport star may, however, also manage his or her own image rights. Examples of South African sport stars who have retained exclusive control of their image rights include Springbok rugby players, Siya Kolisi<sup>18</sup> and Pieter-Steph du Toit.<sup>19</sup>

## 2.2 Intellectual property law

Currently, a South African sport star does not hold a specifically recognised proprietary interest or property right in his or her likeness or *persona*, and it can therefore be concluded that current South African legislation does not recognise image rights as stand-alone rights.<sup>20</sup> Therefore, existent intellectual property law is used to understand how a sport star's image rights can be protected and commercially exploited so as to ultimately establish the tax consequences of monies received from the exploitation of the image

13 B Enoch 'How athletes get endorsements and sponsorships' 9 March 2020 <https://opendorse.com/blog/how-athletes-get-endorsements-and-sponsorships/> (accessed 23 August 2020).

14 A Sierra 'Juventus strike new sponsorship deal thanks to Cristiano' 13 February 2020 [https://en.as.com/en/2020/02/13/football/1581584493\\_640286.html](https://en.as.com/en/2020/02/13/football/1581584493_640286.html) (accessed 23 August 2020).

15 Y He 'Predicting market value of soccer players using linear modelling techniques' in University of California, Berkeley 'Technical Report' (2015).

16 As above.

17 N Srivastava *Sportskeeda* 'How are player image rights managed in football?' 23 October 2015 <https://www.sportskeeda.com/football/how-player-image-rights-managed-football/2> (accessed 18 May 2019 & 23 August 2020).

18 J Gous 'Image rights might have kept Springbok star in South Africa' 5 June 2020 <https://www.swart.law/post.aspx?id=69> (accessed 25 October 2020).

19 Sport24 'Daily shot of Express-o –MyTwoCents' 18 May 2020 <https://www.news24.com/sport/OtherSport/daily-shot-of-express-o-mytwocents-20200518-24> (accessed 25 October 2020); S Xabanisa *City Press* 'Pieter-Steph's conundrum to break ranks with pay cuts' 17 May 2020 <https://www.news24.com/citypress/Sport/pieter-steph-conundrum-to-break-ranks-with-pay-cuts-20200516> (accessed 25 October 2020).

20 Bosse (n 12).

right. The two intellectual property laws examined are the Copyright Act<sup>21</sup> and the Trade Marks Act.<sup>22</sup>

The Copyright Act does not define ‘image rights’. There are nine specific classes of work in which copyright can subsist: literary works; musical works; artistic works; cinematograph films; sound recordings; broadcasts; programme-carrying signals; published editions; and computer programmes.<sup>23</sup> Image rights do not fall into any of these categories. Even if image rights were to fall within the ambit of one of the nine classes of work, the work would still need to qualify as ‘original’ work.<sup>24</sup> To qualify as ‘original’, the work must be reduced to material form and the author must be a ‘qualified person’ in terms of the Copyright Act.<sup>25</sup>

If we apply the requirements under the Copyright Act to Messi’s name, for example, his image right would not meet the requirements and would, therefore, not be protected under the Copyright Act.<sup>26</sup> It would in any event be highly impractical to protect the name of someone like Messi under the Copyright Act as every news article written about him would require the author of the article to secure Messi’s permission before publishing his name – failure to do so would infringe on Messi’s copyright.<sup>27</sup> This is because as the ‘author’ of his name, Messi has exclusive statutory rights over his name and the Copyright Act requires that any third party must first obtain the author’s permission before using the work in which he has exclusive statutory rights.<sup>28</sup>

However, under the Trade Marks Act, a trade mark generally includes brand names<sup>29</sup> and has in practice been used by various

21 Copyright Act 98 of 1978.

22 Trade Marks Act 194 of 1993.

23 Sec 2(1) of the Copyright Act 98 of 1978.

24 This can be drawn from the heading of chapter 1 of the Copyright Act 98 of 1978 which refers to copyright in ‘original’ works read together with O Dean et al *Introduction to intellectual property law* (2014) at 16.

25 Sec 2(2) of the Copyright Act 98 of 1978.

26 A name does not fall within any of the nine categories in sec 2(1) of the Copyright Act 98 of 1978. Furthermore, chap 1 of the Act refers to copyright in ‘original’ works. A name cannot be regarded as original. 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’ which is not possible for a sport star’s name.

27 Sec 23 of the Copyright Act 98 of 1978 read together with Dean (n 24) 3; A Copeling ‘The nature and object of copyright’ (1969) 2 *Comparative and International Law Journal of Southern Africa* at 42.

28 As above.

29 D Swart ‘Introduction to the law of trade marks in South Africa’ 13 September 2004 <https://news.wine.co.za/news.aspx?NEWSID=5981> (accessed 22 August 2020); Dean (n 24) 79.

famous sport stars.<sup>30</sup> A trade mark functions to distinguish one person's brand from another and must therefore be inherently distinguishable – it must not be general or be something that may be confused with another mark.<sup>31</sup> The possibility of a trade mark in sport includes, *inter alia*, a sport star's name, catch phrase, nickname, and his or her image rights. For example, former South African Springbok player, Naas Botha, registered his name as a trade mark.<sup>32</sup>

In conclusion, in South Africa, an image right can be registered as a trade mark, but would likely not be protected under the Copyright Act.

### 2.3 Tax Law

Currently, there are no specific taxing provisions regarding the taxation of image rights in South Africa.<sup>33</sup> On 27 May 2016, the South African Revenue Service ('SARS') issued the 'Draft Guide on the Taxation of Professional Sports Clubs and Players'<sup>34</sup> which was updated on 8 March 2018 (first issue of the Guide) and was subsequently replaced by the second issue of the Guide, which was issued on 21 October 2020.<sup>35</sup> SARS explained that the main purpose of the Guide is to set out and explain the tax consequences for professional sports clubs and players in South Africa.<sup>36</sup>

It should be borne in mind that a published SARS Guide is not to be construed as legislation and is also not an 'official publication' as defined in section 1 of the Tax Administration Act.<sup>37</sup> The Guide issued by SARS is therefore not legally binding and a taxpayer may dispute

30 For example, Lionel Messi, Cristiano Ronaldo, and Usain Bolt have registered their names as trade marks. See further PM Cooper *Lexology* 'Lionel Messi finally registers his name as a trade mark following long legal battle' <https://www.lexology.com/library/detail.aspx?g=23638806-354d-4d22-962f-d6310a25a0e5> (accessed 20 August 2020).

31 Sec 9(1) & (2) of the Trade Marks Act 194 of 1993.

32 Bosse (n 12).

33 There is, a specific withholding tax of 15% levied on foreign sportspersons and entertainers in terms secs 47A-47K of the Income Tax Act. These sections specifically address cases where foreign sportspersons have exercised or will exercise a 'specified activity'. A 'specified activity' is defined in sec 47A as any personal activity exercised or to be exercised in the Republic by a sportsperson or entertainer, whether alone or with other persons. A detailed discussion of these taxation regulations falls out of the scope of this paper.

34 SARS *Guide on the taxation of professional sports clubs and players* (2020) <https://www.sars.gov.za/wp-content/uploads/Ops/Guides/LAPD-Gen-G08-Guide-on-the-Taxation-of-Professional-Sports-Clubs-and-Players.pdf> (accessed 24 January 2022).

35 As above.

36 SARS *Guide on the Taxation of professional sports clubs and players* (2020) <https://www.sars.gov.za/wp-content/uploads/Ops/Guides/LAPD-Gen-G08-Guide-on-the-Taxation-of-Professional-Sports-Clubs-and-Players.pdf> (accessed 24 January 2022) i.

37 *Marshall and Others v Commissioner, South African Revenue Service* (2018) ZACC 11, para 10 read with sec 1 of the Tax Administration Act 28 of 2011.

the views it expresses. The Guide serves as a reference point for how SARS would typically deal with income generated from image rights; it is merely a practice generally prevailing.<sup>38</sup>

The SARS 'Guide on the Taxation of Professional Sports Clubs and Players' refers specifically to image rights and describes them as 'payments that a player receives from an enterprise that uses such player's image for advertising purposes'.<sup>39</sup> When dealing with the taxation of such payments, the Guide states that image rights cannot be 'sold' to another person as they cannot be separated from the sport star.<sup>40</sup> We disagree: Even though 'image rights' are not yet recognised under any intellectual property legislation, the sport star has exclusive control over these rights which, we submit, can be separated from the sport star by registering his or her image rights as a trade mark.<sup>41</sup> Consequently, as with any other trade mark, the star can assign this registrable trade mark to another person or entity as provided for in section 39 of the Trade Marks Act.<sup>42</sup> The transfer of the image rights is effected by a written deed of assignment executed by the assignor of the trade mark (the sport star). The transfer of ownership will generally be recorded in the Register of Trade Marks.<sup>43</sup>

The Guide further makes it clear that where the image rights are registered as a trade mark in terms of the Trade Marks Act, SARS will view payments received by the sport star as income to be included in the star's gross income and subject to income tax.<sup>44</sup> The definition of gross income in the Income Tax Act<sup>45</sup> is broad enough to include amounts received or accrued by a resident on his other worldwide income. As a result, this would include income received by or accrued to the taxpayer arising from a trademark (irrespective whether the trademark is registered or not), but would exclude income of a capital nature.<sup>46</sup> However, the definition of 'gross income' in section 1 of the

38 Sec 5(1) of the Tax Administration Act 28 of 2011 provides: 'A practice generally prevailing is a practice set out in an official publication regarding the application or interpretation of a tax Act'.

39 SARS *Guide on the taxation of professional sports clubs and players* (2020) <https://www.sars.gov.za/wp-content/uploads/Ops/Guides/LAPD-Gen-G08-Guide-on-the-Taxation-of-Professional-Sports-Clubs-and-Players.pdf> (accessed 24 January 2022) 33.

40 As above.

41 Sec 12 of the Trade Marks Act read with Bosse (n 12).

42 Sec 39 of the Trade Marks Act 194 of 1993.

43 Secs 11 & 16 of the Trade Marks Act read with O Dean 'Keep the trade mark assignment baby when throwing out the bathwater' (2004) 71 *Encyclopaedia of brands and branding* at 71.

44 SARS *Guide on the taxation of professional sports clubs and players* (2020) <https://www.sars.gov.za/wp-content/uploads/Ops/Guides/LAPD-Gen-G08-Guide-on-the-Taxation-of-Professional-Sports-Clubs-and-Players.pdf> (accessed 24 January 2022).

45 Income Tax Act 58 of 1962, hereafter 'the Income Tax Act'.

46 Sec 1 of the Income Tax Act definition of 'gross income'.

Income Tax Act specifically includes, in relation to a resident, certain amounts, even if these amounts are generally of a capital nature.<sup>47</sup> In terms of the gross income definition, any amount received or accrued to a person as a premium, or considered in the nature of a premium, for the use or right to use any trade mark, as defined in the Trade Mark Act, is specifically included in the taxpayer's gross income.<sup>48</sup> Therefore, should an entity exploit a sport star's image rights and pay the star premiums for such a right, these premiums will form part of the star's gross income,<sup>49</sup> irrespective of the fact that the image right is registered as a trade mark under the Trade Mark Act or not.

With regards to a non-resident, the definition of 'gross income' provides that the total amount, in cash or otherwise, received by or accrued to or in favour of such a person from a source within South Africa, must be included in that person's gross income.<sup>50</sup> Amounts of a capital nature are, however, excluded.<sup>51</sup> This means that for a non-resident, only income received by or accrued to such a non-resident, which is not of a capital nature, that arises from a source within South Africa would be subject to normal tax in South Africa. The income from the exploitation of a non-resident's image rights will therefore only be taxable in South Africa if the source of such income is within the Republic of South Africa.

The sport star may want to deduct certain expenditure relating to the image rights for tax purposes and one must consider section 11(a) read with section 23(g) of the Income Tax Act in this regard. Section 11(a) sets out the requirements for the general deduction formula for expenditure to qualify for a tax deduction, with the prerequisite in section 23(g) that a deduction will only be allowed where such expenditure is laid out or expended for purposes of carrying on a trade.<sup>52</sup> Addressing relevant permitted deductions, section 11(a)(i) of the Income Tax Act sets out the general deduction formula.<sup>53</sup> The section provides that in determining a person's taxable income derived from carrying on a trade, the person may claim his or her

47 Referred to generally as 'specific inclusions'.

48 Part (g)(iii) of the definition of 'gross income' in sec 1 of the Income Tax Act.

49 As above.

50 Sec 1 of the Income Tax Act definition of 'gross income'.

51 Sec 1 definition of 'gross income', part (ii) of the Income Tax Act. Also see secs 47A-47K of the Income Tax Act.

52 Sec 11(a) read with Sec 23(g) of the Income Tax Act.

53 Sec 11(a) must be read with sec 23H (limitation of certain deductions) in the Income Tax Act; *Port Elizabeth Electric Tramway Company Ltd v CIR* 1936 CPD 241, 8 SATC 13.

expenditure and losses<sup>54</sup> actually incurred<sup>55</sup> in the production of income<sup>56</sup> provided the expenditure and losses are not of a capital nature.<sup>57</sup> Depending on the type of expenses incurred by the sport star in relation to his or her image rights, the expenses incurred may be deductible under the general deduction formula.

However, section 11 also provides for certain specific deductions. For example, section 11(gA)(i) allows for the deduction of expenditure actually incurred by the taxpayer for devising or developing any trade mark as defined in the Trade Marks Act, if the trade mark is used by the taxpayer in the production of his or her income. There is, however, a proviso to this subsection limiting the amount of an allowance permitted as a deduction.<sup>58</sup> Likewise, section 11(gB) allows for a deduction of expenditure, which, first, qualifies as a deduction (partly or in whole) under any of the other provisions of section 11; and second, has actually been incurred in the registration or the renewal of any registration of any trade mark in terms of the Trade Mark Act, if it is used by the taxpayer in the production of his or her income.

We submit that development costs associated with registering the sport star's image rights as a trade mark may be deducted under the provisions of section 11(gA), and the registration costs of the trade mark may be deductible in terms of section 11(gB). Ongoing costs associated with the sport star's image rights may be deductible in terms of section 11(a)'s general deduction formula if all the requirements are met.

A question arises as to whether the sport star can continue to claim a deduction under section 11(a) for expenses incurred in relation to his or her image rights if the image rights have been assigned to the IRC as part of a tax minimisation scheme. In *PE*

54 *CSARS v Labat* (669/10) [2011] ZASCA 157, where the court considered what constitutes 'expenditure' and held that expenditure requires a diminution or movement of assets of the person who expends.

55 *Caltex Oil (SA) Ltd v Secretary for Inland Revenue* 1975 (1) SA 665 (A); *Port Elizabeth Electric Tramway Company Ltd v CIR* 1936 CPD 241, 8 SATC 13. In the *Caltex* case, the court held that the expenditure 'actually incurred' refers to all expenditure where a liability was incurred in that year of assessment, whether or not that liability had been discharged in that same year.

56 In the case of *Port Elizabeth Electric Tramway Company Ltd* (n 55), the court established a two-pronged test to determine if an expenditure had been incurred 'in the production of income'. The court asked: (1) What action gave rise to the expenditure and what was the purpose of the action? (2) Is the action so closely connected with (or a necessary concomitant of) the income-earning business activities from which the expenditure arose as to form part of the cost of performing it?

57 In *SIR v Cadac Engineering Works (Pty) Ltd* 1965 (2) SA 511 (A) the court held that there must be a sufficiently close link to the expenditure that had been incurred and the taxpayer's income earning operations. In other words, the expenditure should not be a cost to expand the taxpayer's income-earning operations (which would make it capital in nature).

58 Sec 11(gA) of the Income Tax Act.

*Electric Tramway*<sup>59</sup> the court held that the expense must be ‘closely linked’ to the operation of the business for it to be incurred ‘in the production of income’.<sup>60</sup> We submit that if the image rights are transferred to the IRC under a minimisation scheme, any costs incurred personally by the sport star in relation to his or her image rights after such a transfer will not give rise to correlating, non-contingent income in his or her hands as it is rather generating income for the operation of the business of the IRC and the required ‘close link’ between the operation of business and the expense incurred by the sport star will have been broken.

In 2001, a South African court in *ITC 1735*<sup>61</sup> had the opportunity to assess whether monies received for the use of a sport star’s name, likeness, and biographical material (i.e., image rights) were to be regarded as an ‘income’ or a ‘capital receipt’ for taxation purposes. The Appellant (a golfer) argued that the income received fell within the ambit of the now repealed section 9(1)(b) of the Income Tax Act, read with the now repealed section 35, which 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.<sup>62</sup> The Appellant therefore argued that if the income constituted gross income, only 30% of the income received by the Appellant should have been subjected to tax. In terms of section 9(1)(b), patents, designs, trademarks, and copyrights are all rights designed to protect the creators of original intellectual works.<sup>63</sup> The court found that the golfer’s name, likeness and so on is not a product of his own creative effort and are of an entirely different nature to the rights listed in section 9(1)(b)(i).<sup>64</sup> The result of the use 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 had, therefore, correctly disallowed the objection and 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.<sup>65</sup> It should be noted, however, that Tax Court judgments do not create a precedent but has persuasive value in future matters.<sup>66</sup>

59 *Port Elizabeth Electric Tramway Company Ltd* (n 55).

60 *Port Elizabeth Electric Tramway Company Ltd* (n 55) para 16.

61 *ITC 1735 64 SATC 455*.

62 *ITC 1735 64 SATC 458* para 10.

63 *ITC 1735 64 SATC 458*.

64 *ITC 1735 64 SATC 459* para 11.

65 As above.

66 Part D of Chapter 9 of the Tax Administration Act 28 of 2011; *ABC CC v CSARS IT 4036* (14 August 2017) at para 23.

### 3 South African tax regulation of image rights payments

Based on the structuring and holding of a sport star's image rights, different tax implications can be triggered. These different tax implications can be illustrated by two scenarios: In the first scenario, income is received directly by a South African sport star for the exploitation of his or her image rights (i.e., the sport star owns his/her own image rights). In the second scenario, the star enters into an IRC scheme in terms of which he or she assigns his or her image rights to an IRC, which is incorporated in a low-tax jurisdiction and only receives income indirectly for the exploitation of the image rights in the form of a foreign dividend declared by the IRC.

#### 3.1 Scenario one – Sport star receives the income directly

The Income Tax Act regulates all taxes attached to the receipt of income from a third party for the exploitation of the star's image rights. In this article, it is assumed that the star is a South African tax resident either because he or she meets the ordinary residence test under the term 'resident' in section 1(a)(i) of the Income Tax Act,<sup>67</sup> or the physical presence test under section 1(a)(ii) of the Income Tax Act.<sup>68</sup>

To illustrate these two scenarios with an example, a South African sport star, Joe Soap, registered his image rights as a trade mark under the Trade Marks Act. He has exclusive control over his image rights. He then enters into an image rights agreement with a luxury watch brand which exploits his image rights by associating its brand with Joe Soap's trade mark in exchange for payment. The monies received by Joe Soap for the exploitation of his image rights will be revenue in nature and not capital in nature for tax purposes based on the image rights which have been registered as a trade mark, which constitutes the 'capital' (i.e., the tree); and the payment made by the third party for the exploitation of the mark is the 'income' (i.e., the fruit) that the tree produces. This is the simple 'fruit versus tree' analogy in tax.<sup>69</sup>

67 This is where the taxpayer considers his or her 'real home' to be. See *Cohen v CIR* 1946 AD 174, 13 SATC 362 at 372. Section 1 definition of 'resident' in the Income Tax Act.

68 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. Section 1 definition of 'resident' in the Income Tax Act.

69 *Visser v CIR* 1937 TPD 82.

Image rights are typically contained in the employment contract concluded by the star with a club or franchise.<sup>70</sup> This part of the agreement will typically stipulate whether payments made by either the club or a third party will constitute payment for services rendered to the club – so qualifying as remuneration and subject to pay-as-you-earn tax<sup>71</sup> – and/or whether this will be a separate source of income for the star which would be included separately in his or her gross income.

It is concluded that in terms of the Income Tax Act, the monies received directly by Joe Soap from the luxury watch brand constitute a profit and form part of his ‘gross income’ as defined in section 1 of the Income Tax Act. In terms of South Africa’s progressive rate structure, the highest rate for an individual is 45%<sup>72</sup>. As mentioned earlier, if the taxpayer retains ownership of his or her own image right<sup>73</sup>s, he or she may also be permitted certain deductions, if all the relevant requirements are met.<sup>74</sup> For purposes of this article, it is accepted that the highest rate will apply and the star’s taxable income (taking into account the income from Joe Soap’s image rights and any relevant deductions and exemptions) will therefore be subject to tax in terms of the 45% tax bracket.<sup>75</sup> This high rate of individual tax is why many stars seek to enter into a tax minimisation scheme by creating an offshore IRC.

### 3.2 Scenario two –The IRC scheme

A very basic depiction of the establishment of an IRC scheme is set out below. This entails a four-step tax-avoidance structure –

**Step 1:** The star assigns his or her image rights to the IRC (incorporated in a low-tax jurisdiction) in which he or she holds shares.

**Step 2:** Third parties enter into image rights contracts with the IRC for the exploitation of the star’s image rights.

**Step 3:** The third parties pay the IRC directly for the exploitation of the star’s image rights.

**Step 4:** The IRC declares and pays the star a foreign dividend.

70 B Strydom & V Sinton ‘Image rights it’s time for clarity and certainty’ (2013) 43 *TAXtalk* at 42.

71 Para 2 of the Fourth Schedule of the Income Tax Act.

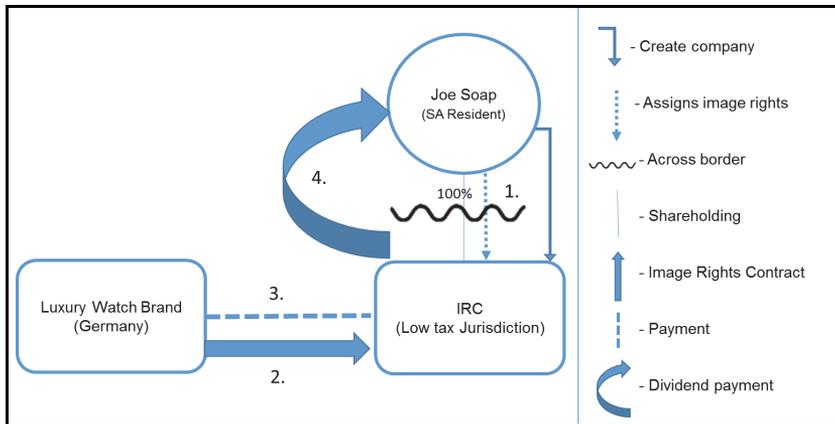
72 <https://www.sars.gov.za/tax-rates/income-tax/rates-of-tax-for-individuals/> (accessed 7 May 2021).

73 See *Port Elizabeth Electric Tramway Company Ltd v CIR* 1936 CPD 241, 8 SATC 13.

74 Sec 11(a), (gA) & (gB) of the Income Tax Act.

75 As an example, for the year of assessment ending 28 February 2021, the rate is tax for someone within the 45% tax bracket would be: R559 464 + 45% of the amount above R1 577 300 (taxable income).

A basic IRC scheme in a 4-step illustration:



This is a simplified structure of what schemes are entered into in practice.

In our example, should Joe Soap assign his image rights to an IRC, he will dispose of an asset in terms of paragraph 11 of the Eighth Schedule to the Income Tax Act. Should a capital gain result from the disposal, Joe Soap will be liable for capital gains tax (to be included in his taxable income for the year of assessment) at an inclusion rate of 40% of the taxable capital gain.<sup>76</sup> The capital gains tax formula is the difference between the proceeds<sup>77</sup> received from the disposal of the asset less the base cost<sup>78</sup> of the asset being disposed of, which gives rise to either a capital gain<sup>79</sup> or a capital loss.<sup>80</sup> However, special anti-avoidance provisions may apply if the parties to the transaction are 'connected persons'<sup>81</sup> and the transaction is not concluded at an arm's length price.<sup>81</sup>

If the image rights are not properly transferred to the IRC, in other words only a right is ceded to the IRC in terms of the exploitation of the image rights, but the ownership of the image rights remains with the sport star or the sport star has a right to regain ownership at a future date, section 7(7) of the Income Tax Act – an anti-avoidance provision – may apply. In terms of this provision, if a cedent (the sport

76 Sec 26A of the Income Tax Act provides that the taxable income of a person for a year of assessment includes the taxable capital gain of that person for that year of assessment as determined in terms of the Eighth Schedule of the Income Tax Act.

77 Part VI of the Eighth Schedule of the Income Tax Act.

78 Part V of the Eighth Schedule of the Income Tax Act.

79 Para 3 of the Eighth Schedule of the Income Tax Act.

80 Para 4 of the Eighth Schedule of the Income Tax Act.

81 Sec 1 definition of 'connected persons' read with paras 38 & 39 of the Eighth Schedule of the Income Tax Act.

star in this example) retains ownership of the asset or has a right to regain ownership of the asset at a later stage and only cedes a right to income by way of donation, settlement or other disposition, the cession agreement is ignored for tax purposes and the income arising from the asset (movable or immovable property) must be included in the hands of the cedent, irrespective of that amount having accrued or received by the cessionary (the IRC). This would most likely be the argument raised by SARS when assessing the sport star, as in the SARS Guide the image rights cannot be separated from the sport star.<sup>82</sup>

The IRC is incorporated in a low-tax jurisdiction and will be regarded as a ‘foreign company’<sup>83</sup> for South African tax purposes if its place of effective management is located outside of South Africa. It is, therefore, possible for a company to be incorporated in one jurisdiction but have its place of effective management in another jurisdiction where it will be deemed to be a tax resident.<sup>84</sup> The place of effective management of a company is ‘where key management and commercial decisions that are necessary for the conduct of its business as a whole are in substance made’.<sup>85</sup> If these key management and strategic decisions are made in South Africa, the IRC is deemed to be tax resident in South Africa and taxed accordingly.<sup>86</sup>

If the image rights registered as a trade mark are assigned to the IRC,<sup>87</sup> one must consider the royalties tax legislation of the country of the paying party and any relevant double tax agreement (‘DTA’) concluded between the countries of residence of the IRC and the payer of the royalty. The relevant DTA could reduce the rate of withholding tax or even assign taxing rights in respect of the royalty payment to the Contracting State of the person receiving the royalty payment (the IRC in this case). This means that no withholding tax on

82 SARS *Guide on the taxation of professional sports clubs and players* (2020) <https://www.sars.gov.za/wp-content/uploads/Ops/Guides/LAPD-Gen-G08-Guide-on-the-Taxation-of-Professional-Sports-Clubs-and-Players.pdf> (accessed 24 January 2022). We disagree and submit that the image rights can be separated from the sport star and in fact sold if they are registered as a trade mark.

83 Sec 1 of the Income Tax Act, definition of ‘foreign company’.

84 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 Southern Africa* at 83. Note that the relevant double tax treaty must be considered in the event of dual residency, but this falls outside of the scope of this paper.

85 *Oceanic Trust Co Ltd NO v CSARS* (2011) 74 SATC 127 para 57; *Customs v Smallwood and Another*. [2010] EWCA Civ 778; Commentary on the OECD Model Tax on Income and on Capital (Full version); SARS Interpretation Note 6 on the Place of Effective Management of Companies (Issue 2); BA van der Merwe ‘The phrase “place of effective management” effectively explained’ (2006) 18 *South African Mercantile Law Journal* at 123.

86 Sec 1 of the Income Tax Act, definition of ‘resident’, para (b). Note that this is subject to consideration of the relevant double tax treaty which, however, falls outside of the scope of this paper.

87 The ownership vests in the IRC.

royalties may be levied on the payment being made.<sup>88</sup> An important consideration with the double tax agreements in terms of the royalties withholding tax article, is establishing the beneficial owner<sup>89</sup> of the royalty. In terms of the Organization for Economic Co-operation and Development (OECD) Model Tax Convention (2017):

[A] conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.<sup>90</sup>

If the IRC in our example is not considered the beneficial owner of the royalty, it will not be entitled to the relief provided in Article 12(1) of the relevant DTA. For the purposes of this article's examples, we have assumed that full ownership of the image rights is transferred to the IRC and that the IRC is the beneficial owner of the image rights.

The IRC, having virtually no expenses, will make a profit from the royalty income and will be able to declare and pay dividends to Joe Soap. Because the IRC is a foreign company, the dividend received by Joe Soap constitutes 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 a foreign dividend received from a company in which such resident holds at least 10% of the total equity shares and voting rights from a resident's gross income.<sup>91</sup> It is assumed for purposes of this article that Joe Soap will qualify for this participation exemption and will therefore not be subject to dividends tax in South Africa. This, in comparison to the high rate of income tax<sup>92</sup> that is levied when Joe Soap receives the image rights payments directly, clearly constitutes a tax benefit for the sport star.

## 4 South African anti-avoidance provisions in IRC schemes

### 4.1 General anti-avoidance provisions

The scheme entered into in scenario two is a result of careful tax planning. To establish whether South African regulations would regard

88 OECD Model Tax Convention and Commentary (2017), Commentary on art 12 para 4.3.

89 OECD Model Tax Convention and Commentary (2017), Commentary on art 12 para 4.3.

90 OECD Model Tax Convention and Commentary (2017), Commentary on art 12 para 4.2.

91 Alternatively, if the IRC is a CFC, sec 10B(2)(c) (subject to sec 10B(4)), provides that the foreign dividend received by the resident is exempt to the extent that the income of the CFC has been included in the resident's income in terms of sec 9D of the Income Tax Act.

92 ITC 1735 64 SATC 459 para 11.

this scheme permissible or impermissible avoidance, the general legislation as provided for in terms of the General Anti-avoidance Regulations ('GAAR') in terms of sections 80A to 80L of the Income Tax Act is first examined. There are four requirements to be met for the GAAR to apply:

- (a) 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'.
- (b) There must be a tax benefit. The general definition provided in section 1 of the Income Tax Act includes 'any avoidance, postponement or reduction of any liability for tax'.
- (c) The sole or main purpose of the avoidance arrangement<sup>93</sup> must be to obtain a tax benefit.
- (d) If the anti-avoidance arrangement is business related, one of four requirements must be met in terms of the arrangement –
  - It must be entered into or carried out in a manner not normally used for *bona fide* business purposes.<sup>94</sup>
  - It must create rights or obligations which are not normally created between persons dealing at arm's length.<sup>95</sup>
  - It must lack commercial substance.<sup>96</sup>
  - It must constitute a direct or indirect abuse of provisions in the Income Tax Act.<sup>97</sup>

When the provisions of the GAAR are applied to the basic IRC scheme, it emerges that the provisions are broad enough to conclude that the creation of an IRC constitutes an arrangement which results in a tax benefit for the sport star. The provisions of the GAAR further inquire as to whether such arrangement is abnormal or *bona fide* for business purposes and whether it lacks commercial sense.<sup>98</sup>

We submit that the only reason for a sport star to enter into a scheme in terms of which he or she assigns his or her image rights to an IRC is to create a 'wall' between him- or herself and the income derived from the exploitation of his or her image rights. This will, however, depend on each case's set of facts. This arrangement appears artificial because the star can negotiate with third parties for the exploitation of his or her image rights whilst he or she is still the owner of these rights. The choice of location of the IRC may also lack commercial reasoning if the sport star does not conduct any business

93 An 'avoidance arrangement' is defined in sec 80L to mean any arrangement that, but for this part, results in a tax benefit.

94 Sec 80A(1)(a)(i) of the Income Tax Act.

95 Sec 80A(1)(c)(i) of the Income Tax Act.

96 Sec 80A(1)(a)(ii) read with sec 80C of the Income Tax Act.

97 Sec 80A(1)(c)(ii) of the Income Tax Act.

98 Sec 80C(1) of the Income Tax Act.

there and the choice is based solely on its status as a low-tax jurisdiction. The IRC established by the star will most likely merely be a shell company with perhaps 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 in our example will clearly lack commercial substance. It is concluded that the general anti-avoidance provisions in South Africa are sufficiently broad to allow the tax authorities to address the tax avoidance arrangement entered into by the sport star.

It is therefore likely that the IRC scheme will be interrogated by the tax authorities and that the courts will very likely conclude that it is an impermissible anti-avoidance arrangement. The provisions of section 80B of the Income Tax Act which detail the punitive measures available to the Commissioner, will then come into play. In the unlikely event of a court finding that the sport star reduced his or her tax liability by structuring his or her affairs in such a manner that he or she committed fraud against the *fiscus*, the star will be guilty of tax evasion.<sup>99</sup>

#### 4.2 Controlled foreign companies

Even if the IRC scheme is not challenged under the GAAR provisions of the Income Tax Act, the Act contains various specific anti-avoidance provisions that would catch this arrangement and tax it accordingly. The applicable anti-avoidance regulations in this case are the Controlled Foreign Company ('CFC') provisions in section 9D of the Income Tax Act.

Although CFC legislation had been implemented in many countries prior to the OECD's Base Erosion and Profit Shifting (BEPS) Project, CFC legislation has been included as an action plan in BEPS<sup>100</sup> to prevent the erosion of the tax base of a jurisdiction through the shifting of profit from the jurisdiction where the profit is received to low-tax jurisdictions.<sup>101</sup> The CFC provisions in the Income Tax Act are very technical and complex, but essentially entail that a foreign company will qualify as a CFC when a resident or residents together hold 50% or more of either the total participation rights,<sup>102</sup> or in absence thereof, voting rights, in the foreign company.<sup>103</sup>

99 Tax evasion differs from tax avoidance in that tax evasion is illegal while tax avoidance makes use of legal ways to reduce tax liability.

100 OECD/G20 Base Erosion and Profit Shifting Project – Action 3: 'Designing Effective Controlled Foreign Company Rules' <https://www.oecd.org/ctp/designing-effective-controlled-foreign-company-rules-action-3-2015-final-report-9789264241152-en.htm> (accessed 7 May 2021).

101 As above.

102 'Participant rights' means the right to participate in the benefits of the rights attaching to a share in the company but excludes voting rights.

103 Sec 9D(1) definition of 'controlled foreign company' in the Income Tax Act.

Returning to Joe Soap, we assume that he, in his personal capacity or along with other South African residents, holds more than 50% 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 requires that the net income of the CFC must form part of Joe Soap's gross income in the ratio of the percentage participation right he holds in the CFC.

In our example, the IRC is established with the sole purpose of receiving the passive royalty income<sup>104</sup> from the exploitation of the sport star's image rights. There are two instances in which the net income of the CFC would be deemed to be nil (and the taxpayer would therefore not be required to include any amount in his or her gross income), namely: the high-tax exemption; or the foreign business establishment.<sup>105</sup> These two exemptions are considered briefly.

The high-tax exemption is regulated in terms of section 9D(2A)(i)(aa) of the Income Tax Act. This section provides that where the total tax payable to a foreign government by the CFC – the IRC in a foreign jurisdiction – is equal to or higher than 67.5% of the normal tax that would have been payable by the CFC had it been a South African tax resident, the net income of the CFC is deemed nil.<sup>106</sup> As Joe Soap in our second scenario incorporated the IRC in a low-tax jurisdiction, this exemption will in all likelihood not apply. The second exemption, a foreign business establishment ('FBE') is regulated in terms of section 9D(2A)(i)(bb). An FBE is defined in section 9D to mean, *inter alia*, a business which is suitably staffed and equipped for conducting its primary operations incorporated in a foreign jurisdiction.<sup>107</sup> 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.<sup>108</sup> The rationale for this exemption lies in the fact that CFC rules do not target income derived from business activities of substance carried on outside of South Africa.<sup>109</sup> In our second scenario, the IRC is established with the sole purpose of its member(s) contracting with third parties for the exploitation of the image rights held by the IRC in return for the receipt of passive royalty payments. It is therefore clear that the IRC would not require a large number of staff, buildings, or equipment,

104 As mentioned above, a 'royalty' is defined as an amount that is received or accrued in respect of the use or right of use of or permission to use any intellectual property and includes a trade mark).

105 Sec 9D(2A)(i)(aa) & (bb) of the Income Tax Act.

106 Sec 9D (2A)(i)(aa) of the Income Tax Act and Stiglingh et al (eds) 'Cross-border transactions' in Lexis Nexis (eds) *Silke: South African Income Tax* (2021) at 867.

107 Definition of 'foreign business establishment' in part (a)(i)-(v) of sec 9D of the Income Tax Act.

108 Sec 9D (2A)(i)(bb) of the Income Tax Act.

109 Stiglingh et al (n 106) 880.

and would not perform the daily activities expected of an FBE. The IRC is merely a holding company incorporated with the sole purpose of receiving passive royalty payments.

The section also contains clawback provisions, which would see certain amounts included in the determination of the CFC's net income, even if, for example, the FBE exemption applies. An example is section 9D(9A)(v) which specifically addresses income attributable to the FBE of a CFC, which arises from the use or right of use of intellectual property.<sup>110</sup> The section provides that where that amount (attributable to an FBE of a CFC) arises from the use or right of use of or permission to use any intellectual property as defined in section 23I, that amount must be included in determining the net income of the CFC. There is an exemption from this rule if both of the following requirements are met -

- (a) The CFC directly and regularly creates, develops, or substantially upgrades any intellectual property as defined in section 23I, which gives rise to the amount.<sup>111</sup> In the typical IRC scheme this would not be case as the IRC is tasked with acquiring, holding, and managing the sport star's image rights and exploiting them for profit. Given the nature of the image rights, we submit that it would be difficult to prove that the IRC has developed or substantially improved image rights in that they are attached to a specific person (the sport star).
- (b) That the intellectual property is not 'tainted' intellectual property as defined in section 23I.<sup>112</sup>

If neither of these requirements are met, the income arising from the use of intellectual property must be included in the net income of the CFC and be imputed to be taxed in South Africa. The CFC legislation will apply to the scheme at hand and the net income of the IRC – i.e., passive royalty payments – received by the IRC will automatically be included in the star's income unless one of the relevant exemptions applies and none of the clawback provisions apply.

## 5 How do other jurisdictions regulate IRC schemes?

### 5.1 Spain – taxing of IRC schemes

What makes Spain unique in relation to its treatment of image rights, is that image rights in Spain are not only recognised by Spanish law

110 Sec 9D(9A)(v) of the Income Tax Act.

111 Sec 9D(9A)(v)(aa) of the Income Tax Act.

112 Sec 9D(9A)(v)(bb) of the Income Tax Act.

(other than in South Africa where they are not yet recognised), but they also enjoy constitutional protection.<sup>113</sup>

Spain has specific regulations – known as ‘the 85% / 15% rule’<sup>114</sup> in the Spanish Income Tax Act, which deal specifically with income derived from image rights. In basic terms, under this rule a sport star or his or her employer (the club) may only assign 15% of the image rights held to an IRC.<sup>115</sup> The remaining 85% must be held directly by either the club or the sport star, depending on the contractual employment relationship as regards the sport star’s image rights.<sup>116</sup> It therefore allows for a portion of the income from image rights to be exempt from Spanish tax in that it may be assigned and consequently taxed in the IRC’s tax residency jurisdiction.<sup>117</sup> Spain, like South Africa, has CFC legislation in its Income Tax Act. The Spanish CFC legislation is, however, not as overly complicated as that in the South African Income Tax Act.<sup>118</sup>

Given that both Messi and Ronaldo have encountered problems with the Spanish revenue authorities regarding the taxation of their image rights, it is clear that the Spanish tax authorities are inclined to look very closely at 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 sanctions, including fines and prison sentences, on taxpayers who enter into such schemes.<sup>119</sup>

## 5.2 United Kingdom – taxing of IRC Schemes

In the UK, the creation of IRCs appears to have developed historically not only for the benefit of the sport star but also for the benefit of the clubs.<sup>120</sup> Over the years, the UK has seen numerous such schemes

113 Art 18(1) of The Spanish Constitution: Fundamental Laws of the State read with E Montejo *Senn Ferrero Sport & Entertainment* ‘Spanish tax situation of image rights’ <http://sennferrero.com/es/opinion/400-spanish-tax-situation-of-image-rights> (accessed 22 September 2020).

114 Art 91 of the Spanish Income Tax Act 35 of 2006.

115 *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 YV Moraga & A Sarrias ‘Sport Image Rights in Spain’ (2010) 3(4) *The International Sport Law Journal* 132.

116 As above.

117 As above.

118 Spanish Income Tax Act 35 of 2006 read with Council Directive (EU) 2016/1164 of 12 July 2016 setting out rules against tax avoidance practices that directly affect the functioning of the internal market [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2016.193.01.0001.01](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.193.01.0001.01). ENG (accessed 7 May 2021).

119 J de Dios et al ‘Spanish tax law: The *Lionel Messi* case’ (2013) 14 *World Sports Law Report* at 16.

120 R Haynes ‘Footballers’ image rights in the new media age’ (2007) 7(4) *European Sport Management Quarterly* 365; C Coors ‘Sports image rights in the UK: Countering tax evasion in the football industry’ (2017) 8(1) *Global Sports Law and Taxation Reports* at 30; P Hackleton & H Julian ‘Image is everything’ (2010) 4262 *LexisNexis*.

which have been tested in the courts more regularly than in South Africa.<sup>121</sup> Her Majesty's Revenue and Customs ('HMRC') published the Guide on 'Tax on payments for use of image rights' in 2017<sup>122</sup> which provided long-awaited guidance on the taxation of income derived from the exploitation of image rights. This Guide is more comprehensive than South Africa's SARS Guide. For example, the UK Guide identifies that payment received by a sport star for the exploitation of his or her image rights can lead to three different tax consequences –<sup>123</sup>

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 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.

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 by applying any single accepted principle.<sup>124</sup>

The *Geovanni* case<sup>125</sup> in the UK examined an IRC scheme in detail and concluded that the scheme lacked commercial substance and was created solely to secure a tax benefit. As mentioned earlier, in the *Agassi* case the UK House of Lords extended the scope of the taxation of foreign sport stars participating in sporting events in the UK.<sup>126</sup> Briefly, Andre Agassi participated in UK tennis tournaments, including Wimbledon, during 1998 and 1999.<sup>127</sup> For these years of assessment, the HMRC wanted to tax endorsement payments made by two of Agassi's sponsors (both non-UK tax resident companies) to his IRC –

121 *Hull City AFC (Tigers) Ltd v Revenue and Customs Commissioners* [2019] UKFTT 227 (TC), [2019] SFTD 754, [2019] 3 WLUK 611 (FTT (Tax)); *Agassi* (n 6).

122 Guidance: 'Tax on payments for use of image rights' <https://www.gov.uk/guidance/tax-on-payments-for-use-of-image-rights> (accessed 27 November 2020) read 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' 16 April 2018 <https://www.markeltax.co.uk/industry-news/https-www-markeltax-co-uk-industry-news-uk-international> (accessed 1 October 2020).

123 Guidance: 'Tax on payments for use of image rights' <https://www.gov.uk/guidance/tax-on-payments-for-use-of-image-rights> (accessed 27 November 2020).

124 Offer (n 122); HMRC Internal Manual – Employment Income Manual EIM00733 <https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim00733> (accessed 5 October 2020).

125 *Hull City AFC (Tigers) Ltd v Revenue and Customs Commissioners* [2019] UKFTT 227 (TC), [2019] SFTD 754, [2019] 3 WLUK 611 (FTT (Tax)) para 133 ('*Geovanni* case').

126 *Agassi* (n 6); Cloete (n 3) 556.

127 *Agassi* (n 6) paras 4-7.

Agassi Inc – which was also not a UK tax resident company, for the use of his image rights.<sup>128</sup> None of these companies conducted any trade in the UK during the years of assessment.<sup>129</sup> Agassi himself had also never been a tax resident in the UK and had merely played in the UK tennis tournaments during the relevant years of assessment.<sup>130</sup> HMRC (the appellant in this matter) based its argument in the House of Lords on the statutory provisions which provide for the taxation of ‘payments that had a connection of a prescribed kind’<sup>131</sup> with a ‘relevant activity’<sup>132</sup> performed by Agassi in the UK.<sup>133</sup> The House of Lords upheld the HMRC’s appeal.

Unlike South African and Spanish CFC legislation, in the UK, a foreign entity will only qualify as a CFC if it meets a broad set of standards. The extant UK CFC legislation in place is, in our view, not up to the OECD standard and will currently not apply to a typical IRC scheme as in our example. This is an unsatisfactory position.

There appears to be a new focus in the UK on the taxation of IRC structures and the potential tax loopholes that IRCs create, and in the 2019/2020 tax year it was reported that HMRC is investigating 246 individual football players in this regard.<sup>134</sup>

## 6 Lessons for South Africa from other jurisdictions

The main inquiry by the courts will be whether minimisation schemes have any commercial substance. This is in line with the well-known South African doctrine of ‘substance over form’.<sup>135</sup> The general anti-avoidance regulations contained in the 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 find that the creation of an IRC will lack commercial substance, as was concluded in the case studies in both Spain and the UK.

However, South Africa does appear to be lacking in a few areas regarding legislation governing image rights. First, South Africa does

128 *Agassi* (n 6) para 5

129 *As above*.

130 *As above*.

131 Reg 3 of the 1987 Regulations; *Agassi* (n 6) para 6.

132 Reg 6 of the 1987 Regulations; *Agassi* (n 6) para 6.

133 The question before the court was if the literal meaning must be given to sec 555(2) of the 1988 Act or a limited effect be applied to exclude from its scope persons who do not reside or carry on any trade in the UK [para 3]. Sec 555(2) of the 1988 Act read with sec 556(1) of the 1988 Act.

134 P MacInnes ‘Tax affairs of 246 footballers being investigated by HMRC in 2019-20’ *The Guardian* 10 August 2020 <https://www.theguardian.com/football/2020/aug/10/tax-affairs-of-246-footballers-being-investigated-by-hmrc-in-2019-20> (accessed 9 October 2020).

135 *CSARS v NWK Ltd* [2011] 2 All SA 347 (SCA).

not have legislation that specifically deals with the taxation of image rights (such as the 85% / 15% rule in Spain) or adequate guidance from SARS that deals in detail with how SARS considers image rights income should be classified and what taxes attach to it (as seen in the UK Guide).

Second, in terms of current intellectual property law, a South African sport star does not hold a specifically recognised proprietary interest or property rights in his or her likeness or *persona*. It can, therefore, be concluded that the current South African legislation does not recognise an image right as a stand-alone right.

It is however satisfying that South Africa has specific legislation that will apply to an IRC scheme as discussed in this paper – e.g., the CFC legislation. Regrettably, the provisions of the South African CFC legislation are overly complex and lead to uncertainties in their application and places an administrative burden on the taxpayer.

In this light, it is suggested that South Africa enact more specific legislation governing the taxation of image rights. This will also enable the Commissioner to adequately prosecute a sport star who enters into an impermissible tax avoidance scheme with greater confidence than the current laws allow.