

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

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1. Introduction

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, and earn income, not only on the field, but also off the field. With reference to sport stars' income generated off the field of play, the concept of 'image rights' must be observed. 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'.¹

The use of someone's image rights can essentially be explained as the practise of appropriating someone's personality.² In our modern society today, people have become transfixed with sport stars, which led to the image rights of individual sport stars such as Lionel Messi and Cristiano 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.³ This use of the image rights of super stars had led to a whole new source of income for these sport stars.

Due to these relatively high amounts of income received for the use of a sport star's image, they may be tempted to enter into creative schemes to try and diminish high taxes levied against these income streams. Both Messi and Ronaldo have used 'image rights companies' (hereafter referred to as 'IRC') to manage their image rights and to reduce their tax liabilities. In these schemes, all income derived from licensing

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¹ R Cloete (ed.) *Introduction to Sports Law in South Africa* (2005) 176

² H Beverley-Smith *The Appropriation of Personality* (2002) 3.

³ R Cloete 'The Taxation of Image Rights: A Comparative Analysis' (2012) 45 *De Jure* 556; S Cornelius 'Image Rights in South Africa' 2008/3-4 *The International Sports Law Journal* 71.

and using the image rights of the relevant sport personality are received by the said IRC company. For tax purposes, these IRCs are generally registered in so called low tax jurisdictions, so that it can receive the most favourable tax treatment.⁴ Both Messi⁵ and Ronaldo⁶ have faced legal problems in recent years because of the use of such IRCs to avoid paying taxes.

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 as recognized as in other jurisdictions, such as the UK and Spain, which we will highlight in this paper.⁷ When examining image rights of sport stars there also appears to be a lack of case law in South Africa.⁸

⁴ 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 on 1 March 2018).

⁵ 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. (Source: 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) .

⁶ Ronaldo 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. He reached a settlement agreement with the Spanish tax authorities in 2019. (Source: 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); EL País '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).

⁷ 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.

⁸ In 2001, a South African court in *ITC 1735 64 SATC 455* 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) were to be perceived as an 'income' or a 'capital receipt' for taxation purposes.

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. The commercialization 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.⁹ 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.¹⁰ Currently, Ronaldo is the sport star with the most Instagram followers in the world, which consequently attracts very lucrative endorsement deals.¹¹

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 big and famous

The Appellant also argued that the income received falls 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. 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, 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 to the rights listed in section 9(1)(b)(i). 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. It should however be noted that Tax Court judgments do not create a precedent.

⁹ 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).

¹⁰ 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).

¹¹ As at 25 October 2020 Cristiano Ronaldo have 241 million Instagram followers.

clubs are more popular and consequently have an increased image rights value. It is due to this type of relationship that it 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 some South African sport stars who have exclusive control of their image rights include Springbok Rugby Players, Siya Kollisi¹² and Pieter-Steph du Toit.¹³

2.2. Intellectual Property Law

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 right in its own nature.¹⁴ 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 are the Copyrights Act¹⁵ and the Trade Marks Act¹⁶.

¹² 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).

¹³ 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-steph-s-conundrum-to-break-ranks-with-pay-cuts-20200516> (Accessed on 25 October 2020).

¹⁴ 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).

¹⁵ 98 of 1978.

¹⁶ 194 of 1993.

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.¹⁷ Image rights do 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.

If we use the example of Lionel Messi's name and applied it to the requirements in the Copyrights Act, his image right will not be protected under the Copyrights Act as it will not meet the requirements.¹⁸ It would in any event be highly impractical to have someone like Messi's name protected under the Copyrights Act, because for every news article written about the sport star, 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 copyright.

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 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 his image rights. The South African former springbok player, Naas Botha, also registered his name as a trade mark.¹⁹

2.3. Tax Law

¹⁷ Section 2 (1) of the Copyright Act 98 of 1978.

¹⁸ A name does not fall within any of the nine categories in Section 2(1) of the Copyright Act 98 of 1978. Furthermore, Chapter 1 of the Copyright Act 98 of 1978 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.

¹⁹ 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).

Currently, there is no specific taxing provisions regarding the taxation of image rights. We will however discuss the general taxation regulations in terms of the taxing of an IRC company below.

On 27 May 2016 the South African Revenue Service ('SARS') issued a Draft Guide on the Taxation of Professional Sports Clubs and Players²⁰ which was updated as 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.²¹

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 Administration Act.²² Section 5 of the Tax Administration Act refers to practice generally prevailing which is the way SARS interprets legislation and how they generally approach tax matters in practice. This is once again not legislation which can be enforced upon a taxpayer, but more of a guideline as to how SARS approaches certain tax matters.

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*'.²³

²⁰ 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%200Players.pdf> (Accessed on 10 September 2018).

²¹ 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%200Players.pdf> (Accessed on 10 September 2018).

²² *Marshall and Others v Commissioner, South African Revenue Service* (2018) ZACC 11: '*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*'.

²³ 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%200Players.pdf> (Accessed on 10 September 2018).

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 sports star. We disagree with this view. 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 registering his image rights as a trade mark. 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. 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.²⁴

The Guide further makes it clear that SARS will view these payments received by sports star as income to be included in the star's gross income and therefore subject to income tax. 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 use of any trade mark as defined in the Trade Mark Act, is specifically included in the taxpayer's gross income.²⁵ 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. South African Tax Regulations 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 in two scenarios: The first scenario being when income is received directly by the South African sport star for the exploitation of his image rights and the second scenario is where the star entered into an IRC scheme whereby he assigns his image rights to an IRC which is incorporated in a low tax jurisdiction and only receive income indirectly for the exploitation of his image rights in the form of a foreign dividend.

²⁴ O Dean 'Keep the Trade Mark Assignment Baby When Throwing Out the Bathwater' (2004) 71 *Encyclopedia of Brands and Branding* 71.

²⁵ Part (g)(iii) of the definition of 'gross income' in Section 1 of the Income Tax Act 58 of 1962.

3.1. Scenario One – Sport star received the income directly

The Income Tax Act²⁶ 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 paper it is assumed that the star is a South African tax resident either because he met the ordinary residence test in terms of Section 1(a)(i) of the Income Tax Act²⁷ or physical presence test in terms of Section 1(a)(ii) of the Income Tax Act.²⁸

As an illustrative example for these two scenarios, a South African sport star, Joe Soap, 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 a luxury watch brand which exploits his image rights by associating their brand with Joe Soap's trade mark, in exchange for payment.

The monies that are received by Joe Soap for the exploitation of his image rights will be revenue in nature and not capital in nature, for tax purposes. 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.²⁹

Image rights are typically contained in the employment contract that the star enters into with the club or franchise. This section will typically stipulate whether payments that are made by either the club or a third party would constitute 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 forming part of his gross income, but not being subject to pay-as-you earn tax.

²⁶ 58 of 1962.

²⁷ This is in essence where the taxpayer considers his 'real home' to be; *Cohen v CIR* (13 SATC 362) (1946 AD 174).

²⁸ 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.

²⁹ *Visser v CIR* SATC 271..

It is concluded that in terms of the Income Tax Act, the monies received directly by Joe Soap from the luxury watch brand 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%.³⁰ For purposes of this paper it is accepted that the highest rate will be applicable and the income from Joe Soap's image rights will therefore be subject to 45% tax. It is because of this high rate of individual's tax that stars seek to enter into the tax minimisation scheme by creating an offshore IRC.

3.2. Scenario Two – The IRC scheme

A very basic depiction of the setting up of an IRC scheme is illustrated below. This entails a four-step tax-avoidance structure:

1. *Step 1:* The star assigns his image rights to the IRC (incorporated in a low tax jurisdiction) in which he holds shares;
2. *Step 2:* This parties enter into image rights contracts with the IRC for the exploitation of the star's image rights;
3. *Step 3:* The third parties pay the IRC directly for the exploitation of the star's image rights; and
4. *Step 4:* The IRC declares and pay the star a foreign dividend.

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

³⁰ <https://www.sars.gov.za/tax-rates/income-tax/rates-of-tax-for-individuals/> (Accessed 7 May 2021)

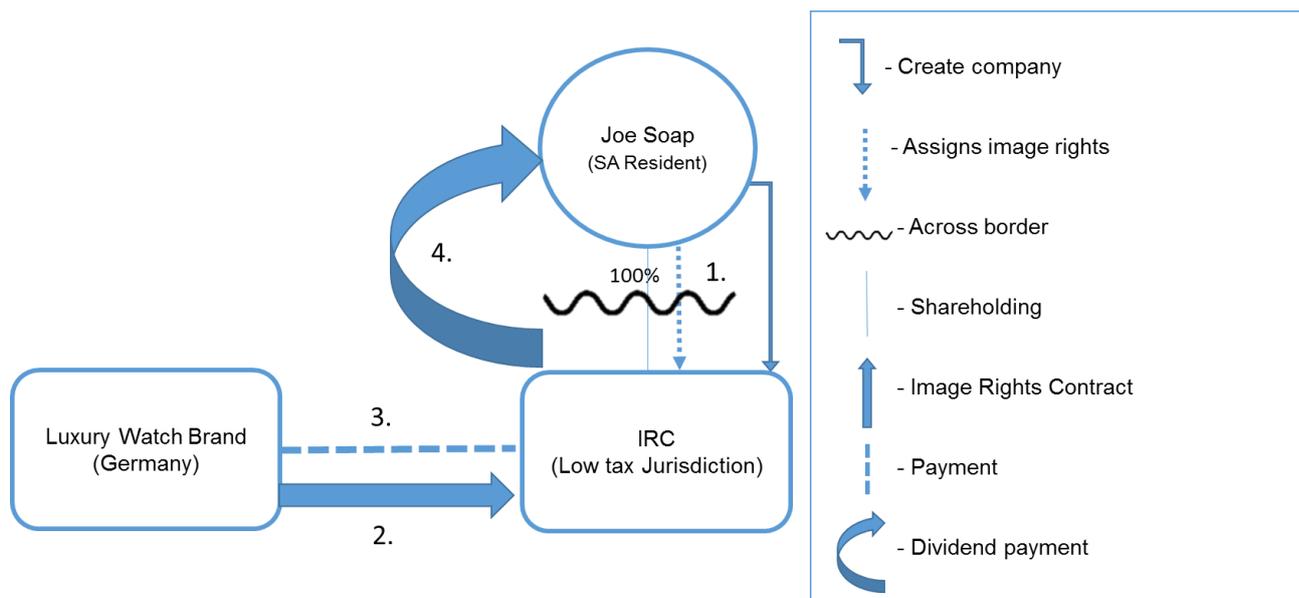


Figure 1 - Basic IRC Structure

The aforementioned is a very simplified structure of what scheme is 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 of the Income Tax Act. He will be liable for capital gains tax at the inclusion rate of 40%, should there be a capital gain from the disposal. As Joe Soap will hold the majority shares in the IRC, the IRC and Joe Soap 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 Eighth Schedule³¹.

The IRC is incorporated in a low tax jurisdiction and will be regarded as a 'foreign company'³², for South African tax purposes, if the company's place of effective management is located outside of South Africa. It is therefore possible for a company to be incorporated in one jurisdiction whilst it has its place of effective management in another jurisdiction, where it will be deemed to be a tax resident.³³ The place of

³¹ In terms of Par 39 of the Eighth Schedule, any capital losses that arise between connected persons will be disregarded in determining the aggregate capital gain or loss of that person. This is often referred to as a 'clogged loss' as it can only be set-off against a capital gain that arises between the same connected persons in future.

³² Section 1 of the Income Tax Act, definition of 'Foreign company'.

³³ 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*

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’.³⁴ In other words, the place of effective management will be where the IRC’s key strategic and management decisions are taken.³⁵ If these key management and strategic decisions are made in South Africa, the IRC may be deemed to be tax resident in South Africa and taxed accordingly.³⁶ The star will therefore have to ensure that such key strategic and management 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 (non-resident) for tax purposes.

The Organisation for Economic Co-operation and Development (‘OECD’) has noted that global digitalisation and new business models of companies may render the current international tax rules such as the ‘place of effective management’ outdated.³⁷ To address this, the OECD/G20 Inclusive Framework has been developing a Two-Pillar approach.³⁸ 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.³⁹ 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 (‘BEPS’).⁴⁰ Considering the current rules that are in place, (and not yet amended as at date of this paper) it will be advisable for the sport

Africa 83. Kindly note that the relevant Double Tax Treaty must be considered in the event of a dual residency, but this falls without the scope of this paper’s discussion.

³⁴ 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.

³⁵ SARS ‘Resident – Place of effective management (companies) Interpretation Note no 6 (Issue 2) (2015).

³⁶ Section 1 of the Income Tax Act, definition of ‘resident’, par (b). Kindly note that this is subject to consideration of the relevant Double Tax Treaty, but this falls without the scope of this paper’s discussion.

³⁷ 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).

³⁸ 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).

³⁹ 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).

⁴⁰ 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).

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.

It is accepted for the purposes of this paper 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 low tax 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 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 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 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.⁴¹ It is assumed for purposes of this paper that Joe Soap will qualify for this participation exemption and he will therefore not be subject to dividends tax in South Africa. This, in comparison to the 45% income tax that are levied when Joe Soap receives the image rights payments directly, clearly constitute a tax benefit for the star.

4. South African Anti-Avoidance Regulations of IRC Schemes

4.1. General Anti Avoidance Regulations

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 ('GAAR') in terms of Sections 80A to 80L of the Income Tax Act is firstly examined.

⁴¹ Alternatively, if the IRC is a CFC, Section 10B(2)(c) the foreign dividend received by the resident would be exempt to the extent that the income of the CFC was included in the resident's income in terms of section 9D.

The provisions of GAAR can be applied to the basic IRC scheme and it will be found 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 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.

We submit 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 choice of location of the IRC may also not have commercial reasoning if the sport star even conducts business there and it is merely chosen since it is a low tax jurisdiction. The IRC that is established by the star will merely be a shell company with maybe 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 clearly will lack commercial substance. It is concluded that the general anti-avoidance provisions in South Africa will be broad enough to allow the tax authorities to utilise in order to prosecute the 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*.⁴² 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

⁴² *CSARS v NWK Ltd (2011) 2 All SA 347 (SCA)*.

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 Act⁴³.

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 in fact catch this arrangement and tax it accordingly. The applicable anti-avoidance regulations in this case is the Controlled Foreign Company ('CFC') provisions in Section 9D of the Income Tax Act.

CFC legislation is created in line with international standards referred to as BEPS⁴⁴ 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 received to low tax jurisdictions. The CFC provisions in the Income Tax Act are very technical and complex in nature, but essentially what it 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 or more of either the total participation rights⁴⁵ or in absence thereof, voting rights, of the company.

In our example with Joe Soap, we assume he, in his personal capacity, or along with other South African residents, 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 require that the net income of the CFC form part of Joe Soap's gross income in the ratio that he holds a percentage participation right in the CFC.

In our example, the IRC is established with the sole purpose that it receives the passive royalty income from the exploitation of the sport star. There are two instances

⁴³ 28 of 2011.

⁴⁴ Base Erosion and Profit Shifting.

⁴⁵ 'Participant rights' means the right to participate in the benefits of the rights attaching to a share in the company (this excludes voting rights).

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.⁴⁶ 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 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.⁴⁷ As Joe Soap in our second scenario had the IRC incorporated in a low tax jurisdiction, this exemption will in all likelihood not apply. The second exemption, a foreign business establishment (hereafter 'FBE'), is regulated in terms of Section 9D(2A)(i)(bb). A 'FBE' 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.⁴⁸ 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.⁴⁹ 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.⁵⁰ 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, buildings, equipment and would not perform daily activities that a FBE would be expected to perform. The IRC is in essence merely a holding company that was incorporated with the sole purpose to receive passive royalty payments.

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.

⁴⁶ Section 9D (2A) (i) (aa) and Section 9D (2A) (i) (bb) of the Income Tax Act 58 of 1962.

⁴⁷ 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.

⁴⁸ Definition of 'foreign business establishment' in part (a)(i) to (v) of Section 9D of the Income Tax Act 58 of 1962.

⁴⁹ Section 9D (2A)(i)(bb) of the Income Tax Act 58 of 1962.

⁵⁰ M Stiglingh (Ed) *et al Silke: South African Income Tax* (2020) 852.

This specific anti-avoidance legislation will apply to the scheme at hand and the net income of the IRC (which constitutes passive royalty payments) received by the IRC will automatically be included into the star's income.

It is concluded that it is a satisfactory position that South Africa has specific legislation that will apply to such 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 a more complex IRC scheme for that reason.

5. How do other Jurisdictions Regulate IRC Schemes?

5.1. Global Exchange of Information

Over the past few years there have been a global war on offshore tax avoidance and evasion. Many taxpayers had undeclared offshore income that revenue authorities were unaware of, and which was therefore untaxed.

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 between countries regarding the true owner of assets and entities, either by way of a specific request for information ('EOIR')⁵¹ or an automatic exchange of information in terms of the Common Reporting Standards ('CRS').⁵² Through these channels, tax authorities can obtain information of taxpayer's offshore bank accounts etcetera and ensure that the relevant taxes are paid. For example, in 2012 South Africa entered into a bilateral Tax Information Exchange Agreement (TIEA) with Bermuda for the exchange of information to tax

⁵¹ Exchange of information on request, 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. 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.

⁵² Common Reporting Standard. CRS is an automatic exchange of information between countries. The CRS is designed with a broad scope in order to prevent taxpayer non-compliance. For example, financial information is exchanged between countries, which includes types of investment income and also account balances and proceeds from sales of financial assets.

matters.⁵³ In 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.⁵⁴

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 who are not paying their relevant taxes, being the ultimate recipients of the image rights income.

5.2. Spain – Taxing of IRC Schemes

What makes Spain unique in relation to their treatment of image rights, is that image rights in Spain 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.⁵⁵

Spain has specific regulations known as the 85%/15% rule⁵⁶ that is contained in the Spanish Income Tax Act which deals specifically with the income derived from image rights⁵⁷.

⁵³ 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](https://www.sars.gov.za/Legal/International-Treaties-Agreements/Pages/Exchange-of-Information-Agreements-(Bilateral).aspx) (accessed on 3 December 2020).

⁵⁴ 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)

⁵⁵ 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).

⁵⁶ Article 91 of the Spanish Income Tax Act.

⁵⁷ In basic terms, under this rule, 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. It therefore allows for a portion of the image rights income to be exempt from Spanish tax (as it may be assigned and consequently taxed in the IRC's tax residency jurisdiction).

Spain also has CFC legislation in their Income Tax Act, as is the case with South Africa, however the Spanish CFC legislation is not as overly complicated as the one in the South African Income Tax Act.

Given that both Messi and Ronaldo have been in trouble with the Spanish Revenue Authorities regarding their image rights, it is clear 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, on the taxpayers who enter into such schemes.⁵⁸

5.3. United Kingdom – Taxing of IRC Schemes

In the United Kingdom ('UK') the creation of IRCs seem 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. Her Majesty's Revenue and Customs ('HMRC') published a Guide in 2017⁵⁹ which gave long awaited Guidance on the taxation of Image Rights. This Guide is a more comprehensive Guide compared to the one that SARS published in South Africa. For example, the UK guide identifies that payment received by a sport star for the exploitation of his image rights can lead to three different tax consequences, namely:⁶⁰

1. Where payment is made to a self-employed sport star, it could be taxable as professional income;

⁵⁸ J de Dios *et al* 'Spanish tax law: the Lionel Messi case' (2013) 14 *World Sports Law Report* 16.
⁵⁹ 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).

⁶⁰ 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).

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.

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.⁶¹

The Geovanni-case⁶² in the UK examined a 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.

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. The UK CFC legislation that are currently in place is, in our view, not up to the OECD standard and will currently not apply to an IRC scheme, which is unsatisfactory.

There seems to be a focus on the taxation of IRC structures and the potential tax loopholes they create and in the 2019/20 tax year, it was reported that HMRC is investigating 246 individual football players in this regard.⁶³

⁶¹ 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).

⁶² 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').

⁶³ 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).

6. 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 schemes (the creation of an offshore 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 conclude that the creation of an IRC will lack commercial substance, as has been the conclusion in the case studies in both Spain and the UK. This is a satisfying conclusion.

Where South Africa does seem to be lacking, 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 governing the taxation of image rights, which will also enable the Commissioner to adequately prosecute a sport star who enters into such a tax avoidance scheme with greater certainty, compared to which the current laws allow.