18 AUGUST 2017

TAX AND EXCHANGE CONTROL ALERT

IN THIS **ISSUE**

CRISTIANO RONALDO, THE LATEST INTERNATIONAL FOOTBALLER INVESTIGATED FOR TAX EVASION IN RELATION TO IMAGE RIGHTS PAYMENTS... WHAT IS THE SOUTH AFRICAN POSITION?

Real Madrid footballer Cristiano Ronaldo recently appeared in court on charges of allegedly evading millions of euros in taxes. The investigation by the Spanish tax authorities and charges laid against Ronaldo comes shortly after his arch-nemesis, Lionel Messi, the Barcelona and Argentina forward, was found guilty of similar offences last year. Ronaldo and Messi form a long line of professional footballers who have recently run afoul of the Spanish tax authorities.

FURTHER CLARITY ON VENTURE CAPITAL COMPANIES

On 24 July 2017, the South African Revenue Service (SARS) released binding class ruling 057 (BCR 057) which deals with, *inter alia*, the eligibility of a partner in an *en commandite* partnership to claim a deduction in respect of venture capital shares acquired by the partnership.

CDH
CLIFFE DEKKER HOFMEYR

CRISTIANO RONALDO, THE LATEST INTERNATIONAL FOOTBALLER INVESTIGATED FOR TAX EVASION IN RELATION TO IMAGE RIGHTS PAYMENTS... WHAT IS THE SOUTH AFRICAN POSITION?

The investigation by the Spanish tax authorities and charges laid against Ronaldo comes shortly after Lionel Messi, was found guilty of similar offences last year.

Real Madrid footballer Cristiano Ronaldo recently appeared in court on charges of allegedly evading millions of euros in taxes. The investigation by the Spanish tax authorities and charges laid against Ronaldo comes shortly after his arch-nemesis, Lionel Messi, the Barcelona and Argentina forward, was found guilty of similar offences last year. Ronaldo and Messi form a long line of professional footballers who have recently run afoul of the Spanish tax authorities.

With the advent of television and a variety of other technologies, sport has become a highly commercialised industry with the ability to attract substantial revenue in the form of, amongst others, sponsorship.

Some footballers have already been convicted and others remain under investigation including, amongst others, Javier Mascherano and Angel di Maria as well as the self-proclaimed "special one", leading international manager, José Mourinho.

In Ronaldo's case, the Spanish prosecutors have accused the Real Madrid footballer of having evaded €14.7 million (around R220 million) in tax. In essence, the allegations include that he made use of various offshore company structures created around 2010 in order to "hide" income generated in Spain from image rights payments. The shell companies were allegedly based in the British Virgin Islands and another in Ireland, both known as low tax jurisdictions. A further charge includes that Ronaldo voluntarily failed to declare €28.4 million in income linked to the sale of his image rights to a Spanish company.

While the Spanish tax authorities have been investigating, charging, and in some cases succeeding in recouping some of the losses to the Spanish *fiscus* as a result of the use of such international offshore image rights holding companies, this comes on the back of a far more developed *fiscal* jurisprudence in countries such as Spain and the United Kingdom in matters of this nature. Nevertheless, it is useful to consider the South African position and examine the key issues from a local perspective.

What are image rights?

With the advent of television and a variety of other technologies, sport has become a highly commercialised industry with the ability to attract substantial revenue in the form of, amongst others, sponsorship. In particular, the image rights of sportspersons have garnered increasing commercial value.

The South African Revenue Services' (SARS) Draft Guide on the Taxation of Professional Sports Clubs and Players (Draft Guide) states at paragraph 5.4.1 the following in this regard:

> South African sports players are, like their overseas counterparts, enjoying the benefit of being able to exploit other commercial opportunities such as image licensing agreements, celebrity endorsements and appearance fees. Image licensing agreements involve the commercial exploitation of a player's image, such as the use of the player's name, photograph, reputation, voice, signature, initials or nickname. Image rights are the

CDH
CLIFFE DEKKER HOFMEYR

CRISTIANO RONALDO, THE LATEST INTERNATIONAL FOOTBALLER INVESTIGATED FOR TAX EVASION IN RELATION TO IMAGE RIGHTS PAYMENTS... WHAT IS THE SOUTH AFRICAN POSITION?

CONTINUED

Within a South African context, image rights could be protected in terms of the common law, the right to privacy in terms of the Constitution, or through statutory intellectual property protection tools, namely copyright or trademark registrations.

> legal rights associated with using the image of a sportsperson in marketing or promotional activities. Image rights payments refer to the payments that a player receives from an enterprise that uses such player's image for advertising purposes.

An illustrative example of this, is of Springbok rugby player Tendai "The Beast" Mtawarira, in the promotion of disposable razors. Ordinarily, disposable razors may be seen as weak, bad quality and untrustworthy, but in the hands of the "The Beast", the product is suddenly associated with toughness, good quality and sustained excellence.

As indicated, South African tax law jurisprudence on this issue is thin, however, in ITC 1735 64 SATC 455, a leading golf professional resident in the UK, but in South Africa to play in the annual Nedbank Golf Challenge at Sun City, entered into a commercial agreement with an international hotel group who agreed to pay the golfer US$100,000 in consideration for certain rights to exploit his intellectual property. Goldblatt J offered the following in respect of the meaning of image rights:

> the utilisation of his likeness, biographical material, his presence at promotional events and media conferences and repeat television/ video utilisation of his participation in the Tournament...

Within a South African context, image rights could be protected in terms of the common law, the right to privacy in terms of the Constitution, or through statutory intellectual property protection tools, namely copyright or trademark registrations.

Image rights payments structures

In essence, the structures set up by Ronaldo and his contemporaries, involve the transferring of the sportspersons image rights to a foreign company typically located in a low tax jurisdiction such as the Isle of Man, Mauritius or one of the Channel Islands. In this scenario, the player incorporates a foreign company where after he divests of his image rights to the foreign image rights holding company. Subsequently, the foreign image rights holding company grants the use of the image rights to the club. The club then pays the player his ordinary salary directly while making payment in respect of the use of his image rights to the foreign company. In this manner, it is hoped that payments made by the sportsperson's club or sponsors for the exploitation of his image will fall outside the South African tax net or result in a more tax efficient structure.

These structures are not limited to sportspersons who form part of teams and thus receive salaries from sports clubs in addition to image rights payments but are also utilised by sportspersons who compete in individual sports such as golf and tennis.

Key tax and exchange control issues

There are a number of issues which need to be considered from a South African tax, legal and exchange control perspective regarding the structure described above, including amongst others, the following:

- whether an individual is, in fact, able to divest of their "image rights" to a juristic person;

CDH
CLIFFE DEKKER HOFMEYR

CRISTIANO RONALDO, THE LATEST INTERNATIONAL FOOTBALLER INVESTIGATED FOR TAX EVASION IN RELATION TO IMAGE RIGHTS PAYMENTS... WHAT IS THE SOUTH AFRICAN POSITION?

CONTINUED

Notwithstanding SARS' view, the position may be different where, for example, a sportsperson divests of certain statutory intellectual property protection tools, namely copyright or trademark registrations.

- whether from an exchange control perspective, a South African resident individual is able to transfer his/her intellectual property to an offshore holding company;
- whether the image rights payments fall within the "gross income" of the sportsperson or are rather of a capital nature;
- to the extent that they do fall within the sportsperson's gross income, whether such image rights payments are subject to employees' tax deductions by the sportspersons employer (i.e. the club or the SA Rugby Union);
- whether SARS could nevertheless utilise the withholding tax on royalties contained in s49B of the Income Tax Act, No 58 of 1962 (Act) such that SARS is still able to levy tax on the amount paid over to the foreign image rights holding company.

SARS' view on the legal parameters and taxation of image rights

SARS' view in the Draft Guide is that a sportsperson cannot divest of their image rights. The Draft Guide states at paragraph 5.4.2 as follows:

> Image rights are essentially personal rights that are vested in the player as an individual person. These rights cannot be separated from the sportsperson, and consequently, cannot be disposed of or "sold" to another person. Further, "a sportsperson has a proprietary interest in his identity and an infringement of such personality right caused by unlawful commercial exploitation can lead to economic loss."

Notwithstanding SARS' view, the position may be different where, for example, a sportsperson divests of certain statutory intellectual property protection tools, namely copyright or trademark registrations.

In respect of the taxation of image rights payments, SARS' view is clear in this regard. The Draft Guide states at paragraph 5.4.2 as follows:

> It is clear therefore that payments made to a sportsperson for the right to use the sportsperson's "image" rights will be included in the sportsperson's gross income and will be taxable as such.
>
> Should such a payment be made to a sportsperson by the club to whom the sportsperson is contracted, such payments will constitute "remuneration" for employees' tax purposes. As the amount paid to the sportsperson for the exploitation of the sportsperson's "image" rights is in these circumstances paid by an "employer" (the club) to an "employee" (the sportsperson) as contemplated in the Fourth Schedule to the Act, the club is obliged to withhold employees' tax and the amount paid for the use of the sportsperson's "image" rights must be disclosed on the sportsperson's IRP5.

CDH
CLIFFE DEKKER HOFMEYR

CRISTIANO RONALDO, THE LATEST INTERNATIONAL FOOTBALLER INVESTIGATED FOR TAX EVASION IN RELATION TO IMAGE RIGHTS PAYMENTS... WHAT IS THE SOUTH AFRICAN POSITION?

CONTINUED

There are a number of key issues one needs to consider in respect of the exploitation of image rights of a sportsperson.

Conclusion

While there is a dearth of fiscal jurisprudence and clear tax legislation in respect of the specific issues relating to the use of offshore image rights holding companies in South Africa it is clear that SARS' view remains that such payments would be taxable in the hands of the South African tax resident sportspersons and may even be subject to employees' tax. Nevertheless, there are a number of key issues one needs to consider in respect of the exploitation of image rights of a sportsperson and it will be interesting to monitor developments in this regard in the hope that further clarity and certainty may be found in the courts in due course.

Jerome Brink

CDH
CLIFFE DEKKER HOFMEYR

FURTHER CLARITY ON VENTURE CAPITAL COMPANIES

Investors subscribe for shares in the VCC and claim an income tax deduction for the subscription price incurred.

On 24 July 2017, the South African Revenue Service (SARS) released binding class ruling 057 (BCR 057) which deals with, *inter alia*, the eligibility of a partner in an *en commandite* partnership to claim a deduction in respect of venture capital shares acquired by the partnership.

Where an investor has used any loan or credit to finance the expenditure incurred to acquire shares in the VCC, the amount of the deduction is limited to the amount for which the investor is deemed to be at risk on the last day of the year of assessment.

In order to place BCR 057 into context, it is imperative that a brief background of the Venture Capital Company (VCC) tax regime be provided. The VCC tax regime, which was introduced into the Income Tax Act, No 58 of 1962 (Act) in 2009, is aimed at encouraging investment into small and medium-sized enterprises and junior mining companies. Section 12J of the Act encompasses the relevant legislation governing VCCs and provides for the formation of an investment holding company, described as a VCC. Investors subscribe for shares in the VCC and claim an income tax deduction for the subscription price incurred. The VCC, in turn, invests in "qualifying companies" (ie investee companies).

The deductibility of expenditure incurred by an investor in acquiring shares in an approved VCC is subject to anti-avoidance provisions. Firstly, where an investor has used any loan or credit to finance the expenditure incurred to acquire shares in the VCC, the amount of the deduction is limited to the amount for which the investor is deemed to be at risk on the last day of the year of assessment (s12J(3)(a)). The investor is deemed to be so at risk to the extent that (having regard to any transaction, agreement, arrangement, understanding or scheme in this regard) the incurral of expenditure or the repayment of the loan or credit would result in economic loss to the investor, where no income is received by or accrued to the investor in future years from the disposal of any venture capital share issued to such investor as a result of that expenditure (s12J(3)(b)). However, a proviso to s12J(3)(b) provides that an investor will not be at risk if the loan or credit is not repayable within five years or if such loan or credit is granted to the investor by the approved VCC itself.

Secondly, s12J(3A) of the Act provides that if, at the end of any year of assessment, after the expiry of a period of 36 months commencing on the first date of the issue of the venture capital shares, an investor has incurred expenditure in acquiring any venture capital share issued to such investor by a VCC and, as a result of such acquisition, that investor is a connected person in relation to that VCC:

- no deduction will be allowed in respect of such expenditure;
- the Commissioner for SARS (Commissioner) must, after due notice to the VCC, withdraw the approval of the company as a VCC; and
- an amount equal to 125% of the expenditure incurred in the acquisition of the company's shares by any person must be included in the income of the company, in the year of assessment in which the approval is withdrawn, if corrective steps, acceptable to the Commissioner, are not taken by the company within a period stated in the notice given by the Commissioner.

CDH
CLIFFE DEKKER HOFMEYR

FURTHER CLARITY ON VENTURE CAPITAL COMPANIES

CONTINUED

A company will acquire VCC status if the Commissioner is satisfied that the sole object company, which must be a resident of South Africa, is the management of investments in qualifying companies.

In accordance with s12J(4) of the Act, a claim for a deduction by an investor must be supported by a certificate issued by the VCC stating (i) the amounts that were invested and (ii) confirming that the relevant company was approved as a VCC.

Section 12J(5) sets out the requirements that must be met before a company can be approved as a VCC. More specifically, a company will acquire VCC status if the Commissioner is satisfied that the sole object company, which must be a resident of South Africa, is the management of investments in qualifying companies. In addition, the company, which must be licensed in terms of s7 of the Financial Advisory and Intermediary Services Act, No 37 of 2002, must have complied with all the relevant laws administered by the Commissioner and must have its tax affairs in order.

Recent legislative amendments to s12J have given rise to an increased participation in the asset class and use of the investment vehicle, evidenced by the increasing number of rulings that have been issued by SARS in relation thereto. BCR 057, which is discussed in more detail below, is the latest of these rulings.

Description of the proposed transaction

The applicant, a company incorporated in and resident of South Africa (Applicant) is "engaged in the provision of trust services". An en commandite partnership (Partnership) is formed amongst the Applicant (as the general partner) and between ten and twenty commanditarian or limited partners (Class members).

The Partnership is formed to invest exclusively in approved VCCs. The Partnership will not borrow from third parties, but will obtain cash contributions from the Class Members. A Class Member's share in the income and capital of the Partnership will be in proportion to that Class Member's contribution to the capital of the Partnership.

It is proposed that the Partnership will, at the outset, invest in two approved VCCs which will be managed by a company incorporated in and a resident of South Africa (ManCo). Notwithstanding that the investments in each of the VCCs will be made by the Partnership, the Applicant and ManCo will arrange that each individual Class Member be entered into the register of investors in the books of the relevant VCC. Furthermore, each individual Class Member will be issued a certificate contemplated in s12J(4) of the Act (Investor Certificate) in accordance with that Class Member's proportionate investment in the Partnership.

Applicable law in relation to partnerships

En commandite partnerships are fiscally transparent vehicles for South African tax purposes. Each partner must account for its undivided share of the tax effects of a partnership's income statement and assets. In particular, s24H provides the following in regard to the South African tax treatment of a partnership:

1. In terms of s24H(2) read with s24H(5) of the Act, each partner is deemed to carry on the trade or business of the partnership. Any income received by or accrued to the partnership is deemed to have been directly received by or accrued to the partners, in accordance with the participation rights set out in the partnership agreement, and on the same date as the income was received by or accrued to the partnership. Any deductions or allowances that can

CDH
CLIFFE DEKKER HOFMEYR

FURTHER CLARITY ON VENTURE CAPITAL COMPANIES

CONTINUED

In addition, the proposed Investor Certificates to be issued to the Class Members will be acceptable for purposes of s12J(4).

be claimed against such income for expenditure incurred by the partnership, can be claimed by the partners in their own hands (in the same ratio as their participation rights).

2. In terms of s24H(3) read with s24H(4) of the Act, the tax deductions for a limited partner are in aggregate limited to the sum of that partner's capital contributions plus its share of the partnership income. Any excess tax deductions can be carried forward to subsequent years of assessment.

Ruling

SARS ruled that subject to sections 12J(3) and (3A), each Class Member will be entitled to claim the deduction under s12J(2) read with s24H, pro rata to that Class Member's proportionate share of the investment in the Partnership.

In addition, the proposed Investor Certificates to be issued to the Class Members will be acceptable for purposes of s12J(4).

Conclusion

It is important to note that rulings are issued to taxpayers to provide guidance on how SARS interprets and applies the tax law to specific transactions. It is therefore important for taxpayers to be cautious when relying on rulings issued by SARS as persons not party to the ruling cannot bind SARS thereto.

BCR 057 is valid for a period of five years from 30 June 2017.

Gigi Nyanin

CDH
CLIFFE DEKKER HOFMEYR

OUR TEAM

For more information about our Tax and Exchange Control practice and services, please contact:

Emil Brincker
National Practice Head
Director
T +27 (0)11 562 1063
E emil.brincker@cdhlegal.com

Mark Linington
Private Equity Sector Head
Director
T +27 (0)11 562 1667
E mark.linington@cdhlegal.com

Gerhard Badenhorst
Director
T +27 (0)11 562 1870
E gerhard.badenhorst@cdhlegal.com

Petr Erasmus
Director
T +27 (0)11 562 1450
E petr.erasmus@cdhlegal.com

Dries Hoek
Director
T +27 (0)11 562 1425
E dries.hoek@cdhlegal.com

Ben Strauss
Director
T +27 (0)21 405 6063
E ben.strauss@cdhlegal.com

Mareli Treurnicht
Director
T +27 (0)11 562 1103
E mareli.treurnicht@cdhlegal.com

Lisa Brunton
Senior Associate
T +27 (0)21 481 6390
E lisa.brunton@cdhlegal.com

Candice Gibson
Senior Associate
T +27 (0)11 562 1602
E candice.gibson@cdhlegal.com

Heinrich Louw
Senior Associate
T +27 (0)11 562 1187
E heinrich.louw@cdhlegal.com

Varusha Moodaley
Senior Associate
T +27 (0)21 481 6392
E varusha.moodaley@cdhlegal.com

Louis Botha
Associate
T +27 (0)11 562 1408
E louis.botha@cdhlegal.com

Jerome Brink
Associate
T +27 (0)11 562 1484
E jerome.brink@cdhlega.com

Gigi Nyanin
Associate
T +27 (0)11 562 1120
E gigi.nyanin@cdhlegal.com

Nandipha Mzizi
Candidate Attorney
T +27 (0)11 562 1741
E nandipha.mzizi@cdhlegal.com

JOHANNESBURG

1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa. Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN

11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com