IMAGE RIGHTS AFTER FINANCE ACT 2010

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The 2011 Champions League Final

The Finance Act 2010 includes, at Schedule 20, an exemption from income tax for the players[1] of any foreign team that plays in the 2011 Champions League Final to be held at Wembley in 2011[2]. It is understood that without this specific exemption it would have been impossible for UEFA[3] to agree to hold the final in the United Kingdom given this country's onerous tax regime so far as it applies to entertainers and sportsmen, particularly taking account of the new 50p top rate income tax rate. This rate is all the more punitive when one compares it with the special top rate that applies, apparently, to Spanish footballers of only 25%.

Under the new rules relating to the Champions League Final and subject to various anti-avoidance provisions the position will be that members of teams[1] in the 2011 Champions League Final will not be subject to UK income tax in respect of duties or services performed in connection with the final nor will there be any obligation for anybody, making any payments to these footballers, to deduct and account for income tax under the entertainers and sportsmen provisions.

The Entertainers and Sportsmen provisions

It is in relation to these last provisions that this article focuses because the whole question of endorsement payments, including payments for image rights has, over the years, becomes a major issue for foreign sportsmen and entertainers coming to the United Kingdom and at the same time, has proved an enormous tax windfall for the Exchequer. And, as an aside, given that the footballers playing in the Champions League Final will all be employees of their clubs, rather than self-employed traders, the exemption is aimed, in effect, exclusively at the endorsement income of those players – not the remuneration paid.

In this article I refer to the entertainers and sportsmen legislation and by this I mean the legislation that started its life within the Finance Act 1986 Schedule 11 before becoming found in four sections of the Taxes Act 1988 at Part XIII Chapter 3, viz: ss.555 to 558, and now ending up (as part of the tax simplification process) in the following three statutes:-

- the Income Tax Act 2007, ss.965 to 970;
- the Corporation Taxes Act 2009, s.1309; and
- ITTOIA ss.13 and 14.

Only a curmudgeon would doubt that exchanging *four* sections of *one* single Act for *various* sections of *three* separate Acts naturally fell under the heading "simplification".

In addition to the legislation mentioned, one also has to take account of the Income Tax (Entertainers and

Sportsmen) Regulations 1987/530 and these are referred to where relevant as the “Regulations”.

Before the entertainers and sportsmen legislation

So how did we get here?

Prior to the introduction of the entertainers and sportsmen legislation in 1987 it was clear that there were problems for the UK Revenue. Entertainers and sportsmen who came to the United Kingdom in their own right (rather than being employees of a club, for example) were, almost entirely, self-employed traders. Back in the Eighties, they were taxed under what was then known as Schedule D Case I and they were taxed on the preceding year basis which applied. This made collection of the tax very difficult for the authorities. A rock singer might appear in the United Kingdom for one day. He or she might be entitled to a significant payment for that performance which would be paid gross. Since the tax could not be computed until the following year, by which time the entertainer would almost certainly be out of the jurisdiction, it might be difficult to track down the entertainer and recover the tax. The same applied to sportsmen and in particular, those who were entitled to tournament winnings such as tennis players and golfers.

How are the rules structured?

Accordingly, legislation was introduced in the Finance Act 1986, together with the Regulations to cater for this. In very broad terms, the joint effect was that where a non-resident individual performed a *relevant* *activity* in the United Kingdom then two things followed:-

(a) first, the payer had to *withhold* UK income tax, at the basic rate, on the payment; and

(b) secondly, the entertainer or sportsman was treated as *trading* in the United Kingdom in relation to that relevant activity. (*This was to curtail arguments that a one-off appearance in the United Kingdom did not amount to a trading activity – the "new" law made it clear that it was.*)

The definition of a "relevant activity" is found in Regulation 6 and it is by no means straightforward.

Regulation 6(1) provides that any activity performed in the United Kingdom by an entertainer (which includes a sportsman) (whether alone or involving others) of any of the descriptions in Regulation 6(2) is an activity of a prescribed description for the purposes of the legislation (and therefore a relevant activity).

By virtue of Regulation 6(2) a relevant activity is an activity performed in the United Kingdom by an entertainer in his character as entertainer or in connection with a commercial occasion or event and includes –

(a) any appearance of the entertainer by way of or in connection with the promotion of any such occasion or event;

(b) any participation by the entertainer in or for sound recording, films, videos, radio, television or other similar transmissions (whether alive or recorded);

A commercial occasion or event to which paragraph (b) above refers includes any description of occasion or event –

(a) for which an entertainer (or other person) might receive or become entitled, for or by virtue of the entertainer's performance of the activity, to receive anything by way of cash or any other form of property; or

(b) which is designed to promote commercial sales or activity by advertising, the endorsement of goods or services, sponsorship, or other promotional means of any kind.

So, this is by no means the clearest piece of wording. However, from the mid 1980s to more or less the end of the 20th Century, advisers on the one hand and the Revenue on the other, contrived a reasonable way of dealing with this legislation, based loosely on the foregoing.

Winnings – straightforward

So far as *winnings* were concerned the tax position was straightforward. If the winnings were from tournaments in the United Kingdom, they were clearly within the legislation; if the winnings were from overseas tournaments, they were not.

Endorsement payments – more difficult

The difficulty came in relation to foreign endorsement payments. So, if a golfer received money for using particular golf clubs, or wearing particular clothes (*and let's face it, some of them would need to be paid considerable amounts to wear their outfits*) or a motor racing driver was paid to wear a particular watch (*am I alone in watching with amusement as motor racing drivers make a dramatic point of putting on their Rolex watches in front of the camera above all else, when making their way to the podium!*) then, the question arose as to whether any of those sums paid by foreign endorsers fell into charge.

All embracing nature of endorsement payments

In the *Agassi*[4] case (*missing out much detail*), a German company paid an American company sums of money as consideration for Andre Agassi, an employee of that American company, using its tennis racquets. The question was whether those payments were subject to UK tax especially bearing in mind that to be within the legislation the payments from Germany to the USA had to fall within the obligation (in the German payer's hands) to deduct UK tax at the appropriate UK rate which obligation, in turn, had to be enforceable in the United Kingdom and subject to a UK penalty for failure to do so. The House of Lords, *with Lord Walker dissenting*, held, in effect, that *all* worldwide payments initially fell within the regime subject to the application of the Regulations to ascertain a chargeable proportion. In other words, the effect of this was that any person, wherever in the world who made a payment that *could* fall within the UK regulations first had to know the basic rate of UK income tax and secondly had to withhold that amount. (Lord Walker, in his dissenting opinion, doubted that this could possibly be the case. He queried whether Parliament could have intended that "a small company trading only in Taiwan or Thailand would be in breach of its [UK] statutory duty and exposed to [UK] penalties for breaching UK regulations of which it might have no knowledge".)

As an aside, the new legislation, which is now found in ITTOIA 2005 s.13, does not include a requirement that for the legislation to apply there must have been a deduction of tax. This change, if you like, is a recognition that the old legislation was unenforceable and, in addition, that Lord Walker's observations were justified.

Applying the regulations

Anyway, the question is how to find a way of computing the appropriate proportion of those worldwide payments which should be charged to UK tax. Going back to the legislation, and in particular the

Regulations, the first step is to identify in relation to an endorsement contract some sort of an activity performed in the United Kingdom to which *some* (and here comes another point) of the *total* endorsement payment could relate. So we need to look at one last element of the Regulations which is Regulation 16, which provides that where you have a global payment in respect of activities, some of which are UK-related and some of which are not, then you apply and just and reasonable apportionment. But what is just and reasonable?

As mentioned, in the early days the two parties in the debate (advisers and Revenue) found an acceptable approach to this area. More particularly, so far as the overall endorsement payment was concerned, two steps were involved. The first step was to take the global endorsement figure and to apportion it into what was called "active income" on the one hand and "passive income" on the other: the passive element fell out of charge. The second step, having ascertained this reduced amount was to apply a formula to ascertain how much of that reduced amount related to the United Kingdom and was therefore taxable. This calls for an example.

Example – old approach

Assume, therefore, that we have a foreign tennis player and assume that in one tax year he earnt £100,000 from UK tournaments by way of winnings and £900,000 from foreign tournaments.

Let us also assume that the tennis player received a total amount of worldwide endorsement income (from the use of tennis racquets, tennis clothing, watches and so on and also from allowing his image to be used passively) and that the total was £2m.

As already mentioned, taxing the winnings is easy. Only £100,000 is subject to UK tax and the relevant tournaments (Wimbledon and so on) would already have deducted tax. The individual then will include the £100,000 within a UK tax computation, taking account of the amounts withheld and any double tax relief. I say this is easy. Of course, practically speaking, it is anything but because there is a huge amount of correspondence involved with the authorities and if the individual has received winnings all round the world, then he can thank his lucky stars that the other authorities are not as difficult as the UK authorities otherwise he would probably never have a penny left after the costs of dealing with all the correspondence involved.

So, continuing with the example, we now look at the endorsement income. Up until about 1999 the question was how much of the £2m in the example was "active" and how much was "passive".

"Active" is what relates to payments that can be said, more or less, to be in connection with actually playing tennis, in this example. "Passive" would be where the individual were asked to attend, let us say, at a dinner for a fee, or to appear on a television programme and perhaps be a member of a panel, or just to have his photograph taken for various magazines. There was no science on this but this approach seemed to work reasonably well.

So, in our example, let us assume, just to make it simple, that half of the £2m. is active and half is passive. This is easy: we just reduce the £2m. down to £1m.

We then have to find a formula to work out how much of this £1m. relates to UK activities. The formula up until about 1999 was straightforward. The denominator was usually the total number of days in the year (365) less, typically, 35 days which took care of a rule of thumb that about five weeks of a sportsplayer's year was said to be spent on holiday. So the denominator would be 330. As to the numerator, if let us say, a tennis player had spent seven days playing at Queens, fourteen days at Wimbledon and, say, two days doing exhibition matches at the Albert Hall or something like that, then the numerator would be 23.

So the calculation would be as follows:

$$1 \text{ million} \quad \times \frac{23}{330} = £69{,}696$$

Accordingly, the tennis player suffered UK tax on just under £70,000.

(As an aside, under the old rules the figure of 23 would be *increased* if the player spent time practising in the United Kingdom and, in addition, the figure *might* be further augmented by days of travel to, or from, the

United Kingdom – but that was subject to specific negotiation.)

New approach

Then at the end of the 1990s the Revenue had a unilateral change of practice. They decided that, in essence, they would not any longer accept that there was any reduction for the so-called passive element and, in addition, they began to challenge the formula itself. These two stances have proved catastrophic from the point of overseas players coming to the United Kingdom.

So if we go back to our example we now find that the same tennis player will have the *whole* of the £2m. brought initially into charge, not just £1m. The denominator will be reduced to the number of days which the tennis player may actually *play* tennis in the world, including the United Kingdom. This may seem straightforward and reasonable to begin with but it is not. It is unfair to look just to days of actual *playing*; training and related activities are hugely important. In my experience, the majority of tennis players practise or play tennis or are involved with tennis virtually every day of the year. I have spoken to a Wimbledon champion who told me quite categorically that she played tennis on *every* day of the year, including Christmas Day. Jonny Wilkinson, the rugby player, kicks a rugby ball, it would seem, every day of the week regardless. So, on this basis, the denominator should be *increased* from 330 to 365, but what is happening is that the Revenue are *reducing* it dramatically, and in the case of a tennis player, to perhaps 140. This is based on the number of actual worldwide tournament days that are spent and it ignores any practice days. It also ignores days involved in testing which is unreasonable given that a great many sports players are paid to try out equipment. The tennis player to whom I spoke explained how she was involved in designing sports clothing and she would advise manufacturers of the length of the tennis skirt that should be used so that when she served the skirt did not get caught up in her follow-through. Other players help with the dynamics of a tennis racquet, and we all know about motor racing drivers whose skill in car *testing* is legend.

Example – new approach

Anyway, going back to where we left off, let us apply HMRC's new approach to our tennis playing receiving a gross figure of £2m. by way of worldwide endorsement income. First, it is this figure of £2m. that is used rather than £1m.: the passive element is added back in; the numerator is (still) 23; but the denominator is only 140.

$$\text{£2million} \times \frac{23}{140} = \text{£328,571}$$

So, the taxable amount has increased from under £70,000 to nearly a third of a million pounds and, to make matters worse, the top rate of tax has been increased to 50%.

Indeed, if one believes the stories that one hears, there are now famous sportsmen who are reluctant to come to the United Kingdom because just stepping foot in the United Kingdom will invoke endorsement problems; whereas if they stay out of the United Kingdom for a whole year their worldwide endorsement income escapes UK tax. Accordingly, a golfer playing in the Ryder Cup in the United Kingdom (where there is no prize money) for four days or so may suddenly find that a dramatic proportion of his worldwide income now becomes subject to United Kingdom taxation and the same may be true in relation to the British Open where, unless he does very well, he will actually be losing money.

Extravagant examples

Indeed, the new approach of the Revenue does give rise to an extravagant example which was mentioned earlier in the year in an article in the Sunday Times in connection with the marathon runner, Paula Radcliffe. She is resident outside the United Kingdom. It was explained in the newspaper that typically she runs two marathons a year (one of which is the London Marathon) but, of course, she will spend, on top of those two competition days, many many hundreds of days training. If she earns £1m. from endorsement income then under the previous procedure, assuming that she ran one marathon in the United Kingdom but trained for 330 days a year, only $^{1}/_{330}$ of her worldwide income would fall into UK tax. Under the Revenue's new approach, the formula becomes ½. This is on the basis that she runs (only) the London Marathon and the New York Marathon in one year. So in this example, her taxable endorsement income increases from £3,030 to £500,000.

Footballers

So, now we come back to the need for special rules for the 2011 Champions League.

Most footballers are employees in relation to their playing contracts, but may be self employed traders in relation to their personal endorsements. So the rules under review would definitely affect them.

If foreign footballers come into the United Kingdom (for the 2011 Champion League Final) and, let us say, they wear particular football boots that are the subject of an endorsement contract then by playing football in the United Kingdom, the Revenue will argue that the final is a commercial occasion "which is designed to promote commercial sales and activity" even though this may be stretching the legislation a little bit. A sizeable chunk of their worldwide endorsement income would then fall into charge. Hence the need for the relieving rules in the Finance Act 2010.

The future

It is clear that we do need a test case to deal with this area of tax law and in particular we need a case to sort out the way in which the apportionment operates. It is simply "unseemly" to pass legislation to encourage footballers to come here for a one-off game but continue to tax golfers, tennis players, motor racing drivers and others, the minute they set foot into this country, and not apply the same treatment to these individuals as are to be applied to the 2011 European Cup finalists.

In particular, we need clear guidance as to how much of a global fee falls out of charge entirely because it is *passive* income; and it seems most unfair to ignore the enormous amount of time spent by sportspeople in training and practising when calculating a reasonable proportion of endorsement income to be subject to UK taxation.

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[1] The definition of "exempted" taxpayers goes wider than just "players" and "members of teams".

[2] For any "budding" judges, the Champion League Final is a game of association football ("soccer") played between the two European soccer clubs who win their way to the final. The competition is open to the top soccer teams in the affiliated European leagues.

[3] Union of European Football Associations.

[4] *Agassi v. Robinson* (77 TC 686).