

# INCOME TAX IMPLICATIONS FROM THE TRANSFER OF SOCCER PLAYERS IN SOUTH AFRICA

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## Abstract

Sports clubs often trade players with each other through the player transfer system. Using the doctrinal research methodology, which involves an extended review of literature, the study aims at providing an interpretative analysis of the income tax implications from the transfer of professional soccer players between professional soccer clubs, based on the Income Tax Act 58 of 1962 (South Africa, 1962) (hereafter the Act) and the relevant case law. This study further provides hypothetical case studies that provide different scenarios of soccer player transfers and the analysis of the income tax implications arising from the facts presented in each case study.

## Keywords

Transfer fees; player rights; player transfer process; sports industry tax; professional soccer players; professional soccer clubs; income taxes.

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## **1. INTRODUCTION**

Sport players can be transferred locally between clubs of the same local soccer national association or they can be transferred internationally through the Fédération Internationale de Football Association (hereafter FIFA). The transfer of players between professional clubs is done according to FIFA's Regulations on the Status and Transfer of Players (hereafter FIFA Regulations) (FIFA, 2012). Once the process of player transfer has been completed and approved by the relevant soccer national association, the buying club will have the exclusive right to use the player for its official matches.

In 2010, the South African Revenue Services (hereafter SARS) issued the "Draft guide on the taxation of professional sports clubs and players" (hereafter Guide) (SARS, 2010a). This Guide, issued as a draft in 2010, had not yet been finalised at the completion of this study. The purpose of this Guide is to provide general guidance on the taxation of professional sports persons and sports clubs (*id.*). The Guide therefore deals with the spectrum of topics specifically relating to the sports industry and addresses the taxation of transactions that arise from the transferring of players between sports clubs in particular.

The objective of this study is to provide an interpretative analysis of how the transfer fees arising from the transfer of professional soccer players between soccer clubs should be subject to income tax in South Africa. This analysis has been based on the Income Tax Act 58 of 1962 as amended (South Africa, 1962) (hereafter "the Act" – to which all other unreferenced section number references also refer) as it existed on 31 May 2015 and the relevant case law.

The focus of this study is on soccer and the analysis of the income tax implications is done from the perspective of professional soccer clubs involved in the transfer of players. This means that the study does not analyse the income tax implications arising from any other fees, such as signing-on bonuses payable to the player being transferred and the fees in respect of the loaning of players; however, the free transfer of players is not excluded from the scope of this study. The study also does not deal comprehensively with the technicalities of the double tax agreements that may exist between South Africa and other countries in the case of international transfers. In addition, for the purposes of this study, it is assumed that the professional clubs are "companies" as defined in s 1 of the Act. The implication of this assumption is that the income taxes will be analysed only from the perspective of persons who are not natural persons.

This study discusses:

- the process of transferring players domestically and internationally as provided in the rules and regulations governing the transfer of soccer players
- the meaning of the transfer fees
- the income tax implications of transfer fees from the perspective of transferor and transferee clubs.

The study deliberates briefly on the Guide and presents case studies in the form of practical examples dealing with various scenarios on how transfer fees should be taxed.

## 2. METHODOLOGY

This study is an interpretative analysis of the tax law and incorporates other literature on the research objective to describe the income tax implications arising from a particular transaction. As a result, the mode of inquiry for this study is qualitative and a doctrinal research methodology, which involves an extended literature study of secondary sources, is used.

## 3. BACKGROUND AND EXPLANATION OF THE PLAYER TRANSFER SYSTEM

In this section, the study introduces various soccer governing bodies that are responsible for the regulation of soccer player transfers, elucidates on the technicalities and process involved in the transfer of soccer players between clubs, and provides basic information about the player transfer system that is needed to assess the income tax implications arising from such transactions.

FIFA is the governing body that is responsible for regulating all aspects of soccer in the world, including the transfer of players between clubs. The FIFA Regulations on the status and transfer of players (hereafter FIFA Regulations) (FIFA, 2012) were issued to regulate the transfer of players between clubs. FIFA also allows its member national associations to issue their own rules to regulate the transfer of players between clubs. According to the commentary on FIFA Regulations (FIFA, n.d: art 2.1), these FIFA Regulations are a guideline and can be modified by the national associations to best fit the environment in which the soccer national associations operate. However, there are limitations to what the national associations can modify. These include, *inter alia*, regulations relating to the classification of players as amateurs and professionals, registration of players, and certain regulations relating to the players' professional contracts (FIFA, 2012: art 1.3). In South Africa, the South African Football Association (hereafter SAFA), which is a member of FIFA, has issued its own regulations on the status and transfer of players (hereafter SAFA Regulations) (SAFA, n.d.). These regulations are applicable only to the members of SAFA, such as the National Soccer League (hereafter NSL), which is an affiliate and a special member of SAFA. The NSL on the other hand, also has its own rules governing the transfer of soccer players (NSL, 2011). Members of FIFA cannot create regulations that are in contravention of the FIFA regulations.

FIFA, SAFA and NSL require that soccer players, whether professional (those players who are remunerated for participating in soccer) or amateurs (those players who are not remunerated for playing soccer) must be registered with the relevant association to which they belong (NSL, 2011: art 26.1). In South Africa, the players would be registered with SAFA. However, NSL administers the registration of players who belong to the clubs that participate in its leagues.

Players are also required to enter into professional contracts with the clubs for which they play. The duration of such contracts cannot exceed three years in the case of minor players and five years in the case of adult players (NSL, 2011: art 37.2 & art 37.9).

The regulations prohibit the registration of a player who is a member of more than one club concurrently (FIFA, 2012: art 5.2; NSL, 2011: art 26.5; SAFA, n.d.: art 4.3). The club that holds the player's registration will therefore have an exclusive right to use the player in various competitions in which the club participates. This right can be transferred to other clubs within the same national association or the national associations of other countries. Where a player is still contracted, meaning that the player's contract has not been terminated, a transferor club may

charge a fee for the transfer. This fee is referred to as a "transfer fee". The transferor club may also choose to transfer a player for free or to loan a player to another club. As mentioned, the scope of this study excludes the loaning of players, i.e. where two clubs enter into a contractual arrangement where a player of one club is temporarily allowed to play for the other club to which he is not contracted. Where the player's contract has been terminated, the player is regarded as a free agent and is allowed to change registration to any other club without the transfer fee being payable.

Free agents can register anytime during the soccer season, but the contracted players can transfer to other clubs only during the transfer window periods that run from 1 July to 31 August and from 1 January to 31 January every year (NSL, 2011: art 26.6.1 & 26.6.2).

The process of player transfer has to be approved by the association of the clubs that are involved in the transfer transaction. The process commences with the club that wants to acquire the player rights informing the other club that holds the rights of its intended acquisition. Negotiations between the player and the transferee clubs also take place. Players are usually represented by their agents in these negotiations. The transferor and transferee clubs then negotiate the transfer fees and an application is made to the relevant association to change the player's registration from the old club to the new club. If the association approves the registration, then the registration of the player under the new club is effected and the player can play for the transferee club.

In the case of an international transfer, i.e. a transfer involving the national associations of two different countries, the FIFA Regulations must be followed. In terms of these regulations, the transfer process must be done through the Transfer Matching System (FIFA 2012: Annexe 3). The transferor's national association must issue a clearance certificate to the transferee's national association. Only once this clearance certificate has been received will the transferee's national association be able to register the player under the transferee's club.

Now that the process that is followed when transferring soccer players has been described, the next section will discuss the nature and meaning of the transfer fees.

#### **4. NATURE AND DEFINITION OF THE TRANSFER FEES**

In the previous section, the study elaborated on the process of the player transfer in terms of the soccer regulations. In this section, the study expands on the meaning of the transfer fees and provides various definitions and reasons for their existence.

Gerrard (2002: 49) defines a transfer fee as "a fee payable by the player's new team in order to acquire the player's registration from his previous club". According to the literature, most studies on what characteristics determine transfer fees were done in Europe (Frick, 2007; Dobson & Gerrard, 1999; Speight & Thomas, 1997; Reilly & Witt, 1995; Carmichael & Thomas, 1993). These studies reveal that the player's age, number of games played, number of goals scored in the previous season, and number of international caps help to determine the transfer fees in Europe (Frick, 2007: 431). The authors believe that the same characteristics are pertinent in the South African player transfer market.

Terviö (2006: 957) suggests that the high transfer fees may encourage a club to transfer a good player prematurely if the club is in need of finances. According to Terviö (2006: 958), transfer fees were instigated to protect the smaller clubs from having their players poached by the big clubs

that could offer the players higher salaries. The transfer fees were designed as a reimbursement to the selling club for the training costs incurred. Terviö (2006: 959) opposed the view that the transfer fees are destined for the club to invest in the training of younger players. His study reveals that the wealthier clubs that invest more money on transfer fees spend less on academies for younger players. This makes sense, as the clubs that can afford to buy players probably have more experienced players who were acquired through the player transfer system rather than players who were developed through an internal academy.

Dobson and Gerrard (1999: 262) suggest that the poor financial performance of a club may be the main reason for it being a net seller with more players being sold than players being bought. They suggest that the clubs sell to raise additional revenues and reduce costs in the form of a reduced wage bill so that they are able to be profitable. Likewise, clubs that are net buyers are stronger financially.

Dobson and Gerrard (1999: 265) indicate that not only must the sporting performance of the club be taken into account in valuing a player, but the financial performance of a club must also be taken into consideration. They suggest that a club is likely to generate more revenue from a new player in the form of increased fans, increased gate takings and prize monies. As long as such income benefits can be attributable to the acquisition of a player, they must also be taken into account in valuing a player.

As mentioned in section 3 of this study, a soccer club that holds the player's registration has an exclusive right to use that player. When a player's registration is changed from one club to another, the exclusive right to use the player is being transferred from the transferor club to the transferee club. It can be concluded that the transfer fees are a payment by the transferor club to the transferee club as compensation for the transfer of the club's exclusive rights to use a player if the player's contract duration with the transferor club has not yet terminated.

The remainder of the study will analyse the income tax implications as a result of transferring players between professional clubs. This analysis will be done from the perspective of both the transferor and transferee clubs.

## 5. TAXABILITY OF PROFESSIONAL SOCCER CLUBS IN SOUTH AFRICA

The starting point in assessing the income tax implication arising from the transfer of soccer players is to establish whether the professional soccer clubs enjoy certain exemption status in respect of income taxes in South Africa. There are two sets of exemptions that apply to entities in terms of s 10 of the Act. The first set applies to entities by virtue of their nature of business and the second set applies to the nature of income generated by the entity. In this section, the study considers the exemption available to certain recreational clubs in terms of s 10(1)(c0) of the Act to assess if professional soccer clubs would qualify for this exemption.

In South Africa, receipts and accruals of the recreational clubs are exempt from income tax in terms of s 10(1)(c0) of the Act, provided they are approved by the Commissioner for SARS in terms of s 30A of the Act. "Recreational clubs" are defined in s 30A as:

any non-profit company as defined in section 1 of the Companies Act, 2008 (Act No. 71 of 2008), society, or other association of which the sole or principal object is to provide social and recreational amenities or facilities for members of that company or society or association.

One of the objectives of the professional clubs is to achieve economic results, which Nagy (2012) describes as “meaning profit maximisation through the increase in revenues such as gate takings, prize money winnings, broadcasting rights revenue and reduction in costs”. It can therefore be concluded that professional soccer clubs intend to make money. Consequently, professional soccer clubs do not meet the definition of the "recreational club", as their objective is not just to provide social and recreational amenities or facilities, but also to make a profit. The implication of this is that the professional clubs will be subject to income tax on the receipts and accruals, except when such receipts and accruals are specifically exempt from income taxes in terms of any other section of the Act. The Tax Guide for Recreational Clubs (SARS, 2010b: 5) also confirms that while amateur sporting bodies may qualify as recreational clubs, professional sporting bodies may not be regarded as such.

Professional sporting bodies will therefore be taxed on the receipts and accruals that are not exempt from income tax. If receipts and accruals are capital in nature, as will be discussed in section 6 of the study, then the capital gains tax may apply. The crux thus lies in determining whether transfer fees will be capital or revenue in nature, as they are not specifically exempt from income tax in terms of s 10 of the Act.

## **6. INCOME TAX ANALYSIS OF THE TRANSFER OF PLAYERS**

### **6.1 From the perspective of the transferor club**

The transferor club gives away the right to use a player and receives transfer fees for such player rights. The transfer fees that accrue to or are received by the transferor club in respect of player rights will either be included in gross income in terms of s 1 of the Act, if the requirements of the definition of “gross income” are met, or be subject to the capital gains tax in terms of the Eighth Schedule of the Act if the transfer fees are found to be capital in nature.

The term “gross income” is defined in s 1 of the Act as follows:

“in relation to any year or period of assessment, means,

- i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident, or
- ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic,

during such year or period of assessment, excluding receipts or accruals of a capital nature ...”

If a transferor club is a resident, i.e. it is incorporated, established or formed in the Republic or has its place of effective management in the Republic, the transfer fees received or accrued will be included in the gross income provided that the transfer fees are not capital in nature. If it can be shown that the transfer fees are capital in nature, then the transfer fees will be subject to the capital gains tax. If, however, a transferor club is a non-resident, the transfer fees will be included in gross income if the transfer fees are from a South African source.

The next few paragraphs of the study will discuss the source of transfer fees in the case of international transfer, the element of revenue versus capital in the definition of "gross income", and the capital gains tax effects in the case of transfer fees being regarded as capital in nature.

The Act does not define the term "source". However, it does prescribe certain amounts to be from the South African source in s 9 of the Act. The courts have therefore attempted to construe the meaning of "source". A very famous case that dealt with the meaning of "source" is CIR v Lever Brothers & Unilever Ltd, 14 SATC 1. In this case, it was authoritatively established that the following two questions must be asked to determine if the source of income is in the Republic:

- What is the originating cause of income?
- Where is the originating cause located?

The transfer fee in respect of the transfer of a soccer player is similar to royalties in that while the transfer fee is a consideration payable for the exclusive right to use the player, royalties are a consideration payable for the right to use intellectual property. In *Millin v CIR*, 3 SATC 170, it was held that the source of royalties in the case of a novelist was where the labour, wits and intellect were applied.

In the case of transfer fees, one can say that the originating cause of the transfer fee is the transfer of the right to use the player. Such right will be located in the country of the transferor club, being the country where the player developed, enhanced and exercised his skills to play soccer. It therefore follows that when a non-resident club transfers a player to a resident club, the non-resident transferor club will not be subject to tax in South Africa, as the transfer fee is not from a South African source.

As mentioned, transfer fees of a capital nature are excluded from the definition of "gross income". In the case of the transfer of professional soccer players between clubs, the intention of the transferor club will have to be determined in order to conclude whether the transfer fees are revenue or capital in nature (*Elandsheuwel Farming (Edms) Bpk v SBI*, 39 SATC 163). The intention of the club will usually be determined by the actions of the club owners or the directors of the club (*CIR v Richmond Estates (Pty) Ltd*, 20 SATC 355). The activities of the club during the transfer period will have to be taken into consideration, as these might provide objective factors as to what the directors of the club intended. Under normal circumstances, a player might have been acquired with the intention of being used in the official matches of the clubs so that the club can participate and win competitions or leagues. However, the intention of the club might have changed during the contract term of the player and the club might be considered to have entered into a profit-making scheme. The change in intention was referred to as "crossing the Rubicon" in *Natal Estates Ltd v SIR*, 37 SATC 193.

If it is determined that the transfer fees are capital in nature, then the capital gains tax will apply. The capital gains tax is triggered by a disposal of an asset. In terms of paragraph 11(1)(a) of the Eighth Schedule of the Act, a "disposal" includes transfer of ownership of an asset. The transfer of a professional player results in the ownership of the right to use the player being transferred from one club to another, which amounts to a disposal. The timing of the disposal will be when ownership of the player rights changes, unless there are suspensive conditions imposed on such a transfer by the contracting clubs, in which case, the disposal will take place once those conditions have been fulfilled. On the other hand, an "asset" is widely defined in paragraph 1 of the Eighth Schedule of the Act to include incorporeal property as well as rights to any property. In the case of a professional player transfer, the personal rights to use the player exclusively are being

transferred. Therefore, it can be concluded that these rights are an “asset” as defined in the Eighth Schedule of the Act.

Where a transfer fee is capital in nature, the capital gain or loss must be determined in terms of the Eighth Schedule of the Act as proceeds less base cost. The proceeds are defined as equal amounts received by or accrued to or in favour of the person in respect of the disposal of an asset. The courts have always held that an "amount" does not have to be in money. Anything that has an ascertained monetary value is an amount (*Lategan v CIR*, 2 SATC 16). In *Lace Proprietary Mines Ltd v CIR*, 9 SATC 349, the market value of the assets received was considered to constitute an amount. The proceeds shall be determined in terms of paragraph 35(1) of the Eighth Schedule of the Act as an amount received by or accrued to a transferor club in respect of the transfer of a player, namely, the transfer fees.

The base cost of the player rights shall be the costs of acquisition, namely, the transfer fees paid when that player right was acquired. There will be no base costs in the case of the transfer of a player who was developed internally by the club, or who was acquired through a free transfer or as a free agent, as there would not have been any acquisition costs incurred. The costs of training a player are deductible under s 11(a) of the Act in determining the taxable income of the club, and are therefore not included in the base cost.

In conclusion, transfer fees will be taxable in the hands of the transferor club either through the inclusion of the transfer fees into gross income if they are found to be revenue in nature, or through the inclusion of the taxable capital gain into taxable income if they are found to be capital in nature. The intention of the club, which is a subjective test coupled with objective factors to ascertain the intention of the club, will be a determining factor as to whether the nature of the transfer fees is revenue or capital. The part below will deliberate on the income tax implications for the transferee club.

## **6.2 From the perspective of the transferee club**

The transfer of professional players between clubs involves two parties, namely, the transferor club and the transferee club. This section of the study discusses the possible income tax implications arising from the transfer of players from the perspective of the transferee club. For the transferee club that pays a transfer fee, the transfer fees would be regarded as deductible under s 11(a) of the Act if the requirements of this section were met. In terms of s 11(a) of the Act, “expenditure and losses actually incurred in the production of income” can be deducted from the income, provided such expenditure and losses are not of a capital nature.

To conclude whether the transfer fees are deductible under s 11(a) in determining the taxable income of a transferee club, it must be established that the transfer fees are not capital in nature. In this study, two tests will be used to assess whether the transfer fees are revenue or capital in nature in the hands of the transferee club. These tests are (1) enduring benefit and (2) closeness of connection between income-producing activities.

### *Enduring benefit*

The enduring benefit principle was developed in *British Insulated and Helsby Cables v Atherton* 1926 A.C 205. According to this principle, transfer fees would be capital in nature if a transferee club will obtain an enduring benefit by incurring such expenditure. In soccer, players are usually contracted for a period of three to five years; however, some contracts are for lesser periods. A club needs players in order to participate in tournaments and the league. Without players, a club



would not be able to generate revenue in the form of ticket sales, broadcasting rights and competition prize monies.

In ITC 1063, 27 SATC 57(N), a company formed in South Africa was appointed as a sole distributor of gramophone records in South Africa by another company which manufactured gramophone records. The distributor undertook to pay R27 000 to the manufacturing company in respect of being granted the right to be the sole distributor of the manufacturer's products. The right was acquired for the duration of three years, with the option of renewal for a further two years at the option of the distributing company. The Commissioner for Inland Revenue disallowed the deduction on the grounds that the amount was capital in nature.

The facts of the above case are similar to soccer in that:

- the appellant had to pay for the acquisition of the sole right to distribute the manufacturer's products, whereas in soccer the transferee club pays a transfer fee in order to get the sole right to use the player in its official matches;
- the contract for the right to distribute was for three years with an option of renewal for a further two years; in soccer, the contract for minors is limited to three years and to five years in the case of adult players; and
- the distributor would not have been able to generate profits without the franchise. In the case of soccer, the club also needs players in order to play and subsequently generate income.

Based on this case, it can be concluded that the spending on transfer fees therefore brings an advantage for the enduring of benefits to the transferee club. In this way, transfer fees are likely to be capital in nature and therefore not deductible for tax purposes.

#### *Closeness of connection between income-producing activities*

When expenditure is closely related to the income-producing asset of a taxpayer, the expenditure would be regarded as being capital in nature. On the other hand, when expenditure is related to the income-earning activities of the taxpayer, then the expenditure would be regarded as being revenue in nature.

In the authors' view, the soccer players of a club are the assets and infrastructure of the club; therefore the rights to the exclusive use of the players are indeed the income-earning structure. It therefore follows that the transfer fee is closely connected to the income-earning assets of a club. Consequently, the transfer fees would be capital in nature.

The various income tax implications from the transfer of soccer players are best illustrated through practical case studies. In section 8, the study will provide demonstrative case studies which will show the potential income tax treatment of transfer fees from the perspective of both transferor and transferee club.

## **7. DRAFT GUIDE ON THE TAXATION OF SPORTS CLUBS AND PLAYERS**

As previously mentioned in the introduction, SARS issued a Guide in 2010 to provide general guidance on the taxation of sports persons and sports clubs (SARS, 2010a). The Guide deals with the spectrum of tax matters specifically relating to the sports industry in general. In the section on the taxation of transactions that arise from the transfer of players between sport clubs, the Guide states that transfer fees are capital in nature and subject to the capital gains tax as:

- the rights to use a player are not trading stock,
- the frequency of player transfer per club is limited, and
- the intention of a club is generally not to enter into a profit-making scheme (SARS, 2010a:5).

It further states that:

- if it can be clearly seen that a club has entered into a profit-making scheme and is holding players for speculative purposes, then the transfer fees would be included in the gross income (*ibid* at p6).
- the transfer fees would not be deductible under s 11(a) of the Act in determining the taxable income of the transferee clubs, as they are incurred to increase the income-producing assets of the transferee club, and therefore are capital in nature (*ibid.* at p5).

The problem with the Guide is that it is incomprehensive and does not provide adequate guidance in describing the income tax implications arising from the transfer of sports players. This Guide was subsequently removed from the SARS website and SARS had not issued a final completed guide by the time this study was finalised. It remains uncertain whether SARS still intends to issue this guide in final form.

## **8. HYPOTHETICAL CASE STUDIES**

In this section of the study, five hypothetical case studies are presented and the income tax implications likely to arise from such case studies are analysed. These case studies deal with various aspects of income tax such as gross income, capital gains tax and the general deduction formula, all of which will be discussed in respect of transfer fees. The main objective is to demonstrate, by way of practical examples, the income tax implications likely to arise in various instances relating to the transfer of professional players between soccer clubs. For the purposes of these case studies, the names used are fictitious and all amounts are exclusive of Value-Added Tax. It is also assumed that the same regulations that apply to FIFA, SAFA and NSL will equally apply for the purposes of these case studies. The conclusions reached in each of the case studies are based on the limited facts provided in such case studies. The conclusions could be different, depending on the availability of additional substantial information.

### **8.1 Case Study 1 – Transfer fees being revenue in nature and included in gross income**

#### **8.1.1 The facts of the case study**

Western Cape Stars Football Club (hereafter Western Cape Stars) has a team of 27 players. None of its players was acquired through the player transfer system. Western Cape Stars believes in developing players from its internal academy programme. The players from the lower team are amateurs, as they are not paid for the services they perform. Players in the lower division of the club are then promoted to the first team, based on performance. The selection of players to play for the first team is done through trials where the coach of the first team is involved in the selection. The club will then transfer the rights of any player who has been identified by other clubs. The club will charge different transfer fees depending on how much the player is worth at the time of the transfer. The club is known for making a large number of transfers during the

transfer window, especially closer to the end of the players' contracts so that it will not forfeit the transfer fees. Although the club was participating in the first-tier league, it had been relegated to lower leagues for quite a few years due to poor performance. The club really has no intention of winning the league but is content to participate in the league for the benefit of receiving monthly cash grants from the South African League.

During every transfer window period, the club transfers about six to seven player registrations to other clubs within the South African League clubs. The club has never waited for the contracts of the players to come to an end irrespective of how outstanding the players' performances are. Although the club has been performing badly, it survives financially because of the transfer fees it receives from the transfer of players and the grants received from the South African League. As the club has not been spending any money on acquiring players, all players are not recognised as assets in the statement of financial position of the club. This is because one of the recognition criteria for an "asset" is that the cost of an asset must be measured with reliability (IASB, 2012: A39). The club is therefore likely to make significant profits from the transfer fees, as there are no costs incurred in acquiring these players.

### **8.1.2 Income tax consequences – Western Cape Stars**

The transfer fees are included in the gross income if they are revenue in nature. From the facts given in the case above, it would seem that the club is involved in a profit-making scheme for the following reasons:

- The club never spends money acquiring players but it develops them internally with the objective of selling the rights in future at a profit;
- The club usually transfers a significant number of players to other clubs in any given transfer window period;
- The club has no intention of winning the tournament as it only trains the players. Once players are good, it transfers them to other clubs before their contracts are terminated; and
- The club usually initiates the transfers of players close to the end of their contracts.

The transfer fees will therefore be included in the gross income and be fully subject to income tax, as the club is involved in the scheme of selling players at a profit. The cost of developing the players would have been deducted under s 11(a) of the Act.

## **8.2 Case Study 2 –Transfer fees being capital nature and subject to capital gains tax for the transferor club and not deductible under s 11(a) for the transferee club**

### **8.2.1 Facts of the case study**

Epreim Mahoro, who is 28 years old, has been a player of Kailer Cheirs Football Club (hereafter Kailer Cheirs) for four years. His contract with Kailer Cheirs was initially for five years. Kailer Cheirs is a professional soccer club in South Africa that participates in the South African League. Before the 2014/2015 season ended, Epreim Mahoro was given a good offer by Black Tigers, which also participates in the South African League. Epreim Mahoro feels that it is time for him to change clubs, as he has not been fielded by Kailer Cheirs in its matches recently. He has therefore accepted the Black Tigers' offer. The new contract with Black Tigers will be for three years and will

be renewable at the option of the club at the end of the initial term. Black Tigers has already informed Kailer Cheirs in writing of their intended acquisition, as required by the rules of the South African League that regulates the transfer of players.

Both clubs entered into negotiations and it was agreed that the transfer fee would be R1 500 000, that 50% of the transfer fee, amounting to R750 000, would be payable upon the issue of the clearance certificate by Kailer Cheirs, and the balance would be payable to Kailer Cheirs after the registration of the player was completed. Kailer Cheirs issued a clearance certificate to Epreim Mahoro on 26 June 2015. Kailer Cheirs' financial year ends on 30 June 2015. On 3 July 2015, the change in Epreim Mahoro's registration was effected by the South African League and the registration card of the player was delivered to the player. Black Tigers paid the balance of the transfer fee on 4 July 2015. Black Tigers' financial year ends on 31 July 2015.

Kailer Cheirs acquired Epreim Mahoro through the transfer system from Dynaros Football Club four years before at a transfer fee of R450 000. Kailer Cheirs has already transferred five players this season, three of whom were still contracted players. Two of the transferred players were already out of contract. Kailer Cheirs has always capitalised the transfer fees in its financial statements as intangible assets. The salaries paid to players and the training costs are deducted by Kailer Cheirs under s 11(a) of the Act.

### 8.2.2 Income tax implications for the transferor club – Kailer Cheirs

Kailer Cheirs is a resident and will therefore be taxed on its worldwide income. When transferring the rights to Black Tigers, it does not seem that it was Kailer Cheirs' intention to enter into a profit-making scheme (regardless of having made a profit of R1 050 000 from the sale of the rights), as the player initiated the transfer. This stems from the case: *Stott v CIR*, 3 SATC 253, where it was held that the taxpayer could sell an asset at the best price. The right will therefore be a capital asset.

As discussed previously in section 4, player rights are "assets" as defined in the Eighth Schedule of the Act. In addition, a transfer of an asset amounts to a disposal. The proceeds will be the amount received by or accrued to Kailer Cheirs in respect of the disposal of the player rights, namely, R1 500 000. The timing of the disposal will take place in 2015, as that is when the agreement to transfer players was concluded, and there were no suspensive conditions attached to the transfer of the player rights.

The capital gain for Kailer Cheirs for the 2015 year of assessment will therefore be determined as follows:

	ZAR
Proceeds*	1 500 000
Less: Base cost	(450 000)
Capital gain	1 050 000

\*Refer to section 6 for the discussion on the determination of proceeds and base cost for capital gains tax purposes.

The capital gain determined is not what will be included in the taxable income of Kailer Cheirs. All the capital gains and losses determined for the 2015 year of assessment will have to be aggregated together. Prior year assessed capital losses, if any, will have to be subtracted from the aggregate capital gains. Only 66.6%, being the inclusion rate applicable to companies, of the

net capital gains will be included in the taxable income of Kailer Cheirs in terms of s 26A of the Act.

### **8.2.3 Income tax implications for the transferee club – Black Tigers**

Black Tigers will claim a deduction on the expenditure amounting to R1 500 000 only if it can be shown that the requirements of section 11(a) of the Act are met. It was established that the transfer fees are likely to be capital expenditure due to the fact that the players provide an advantage for the enduring benefit of the club. This therefore means that the general deduction formula element, which requires that expenditure must not be capital in nature, will not be met. Black Tigers will therefore not be able to deduct the transfer fees against income in terms of s 11(a) of the Act. The whole amount will however be included in the base cost when the player rights are eventually transferred.

## **8.3 Case Study 3 – Income tax implications for soccer clubs in case of player swaps**

### **8.3.1 Facts of the case study**

Thabo Moogi is a defender of Diamond Stars Football Club (hereafter Diamond Stars) who was acquired by the club four years ago. Diamond Stars has too many defenders and not enough strikers. In trying to resolve this team imbalance, the chairman of Diamond Stars met with the chairman of Bapedi United Football Club (hereafter Bapedi United), which also participates in the South African League. Bapedi United similarly has a team imbalance in that it has too many strikers and not enough defenders. In terms of the agreement between these two clubs, Diamond Stars will provide Bapedi United with Thabo Moogi, a very good defender. Bapedi United will provide Diamond Stars with Brian Mashego, who is a very good striker. The market value of Thabo Moogi is R1 500 000 at the time of the exchange. Thabo was acquired by Diamond Stars through a transfer system three years ago and the transfer fee paid was R900 000. On the other hand, the market value of Brian Mashego is R950 000 at the time of exchange. Brian Mashego was also acquired through the player transfer system at a fee of R720 000, two years ago. Both players, Brian and Thabo, are still contracted with their respective clubs. The clubs therefore agreed that Bapedi United would pay R450 000 in addition to the exchange arrangement.

### **8.3.2 Income tax implications for both clubs**

The exchange of ownership of an asset amounts to the disposal of an asset in terms of paragraph 11(1)(a) of the Eighth Schedule of the Act. This therefore means that both Diamond Stars and Bapedi United have disposed assets.

The capital gain for Diamond Stars and Bapedi United will therefore be determined as follows:

	Diamond Stars ZAR	Bapedi United ZAR
Proceeds		
Market value of the asset received	950 000	1 500 000
Additional cash	450 000	-
Total proceeds	1 400 000	1 500 000
Less: Base cost	(900 000)	(720 000)
Capital gain	500 000	780 000

The market values of the assets given up and the additional top-up cash payment in the case of Bapedi United will become the base costs for the assets acquired.

## 8.4 Case Study 4 – Free transfer of a soccer player

### 8.4.1 Facts of the case study

Meadowlands Pirates Football Club (hereafter Meadowlands Pirates) is a professional soccer club that participates in the South African League. Benni McCaren, a player of Meadowlands Pirates, has not been performing well in the club. Benni is still contracted to Meadowlands Pirates and his contract is due to expire in one year. He has requested to be released from his contract with Meadowlands Pirates in order to join another club, North West Stars Football Club (hereafter North West Stars). Meadowlands Pirates has agreed to release Benni McCaren from his contract for free, namely, without the transfer fee being payable. Meadowlands Pirates acquired Benni's registration from Kailer Cheirs three years before at a transfer fee of R350 000. Meadowland Pirates and North West Stars are not "connected persons" as defined in s 1 of the Act.

### 8.4.2 Income tax implications for the transferor club – Meadowlands Pirates

The transfer of a player's right is a disposal as defined in paragraph 11(1) of the Eighth Schedule of the Act. The proceeds are defined as "the amount received by or accrued to or in favour of such a taxpayer in respect of the disposal of an asset". As Meadowlands Pirates decided not to charge any transfer fee for Benni, there would not be any proceeds. The capital loss would therefore be determined as follows:

	ZAR
Proceeds	-
Less: Base cost	(350 000)
Capital loss	(350 000)

A capital loss of R350 000 can be offset against other capital gains in determining the aggregate capital gain or capital loss. This capital loss will not be ring-fenced in terms of paragraph 39 of the Eighth Schedule of the Act, as the clubs are not "connected persons".

### **8.4.3 Income tax implications for the transferee club – North West Stars**

North West Stars has acquired an asset, namely, the right to use the player exclusively at no cost to the club. The base cost of the asset acquired would therefore be zero.

## **8.5 Case Study 5 – Third party ownership of players**

### **8.5.1 Facts of the case study**

Moroka Eagles Football Club (hereafter Moroka Eagles) is a professional soccer club that participates in the South African League. During the year, Moroka Eagles went into financial difficulties because of a lawsuit against the club. The club attempted to raise funds from external parties. One of the clubs that also participates in the South African League, the Soweto Giants Football Club (hereafter Soweto Giants), promised to provide a financial bailout amounting to R1 500 000. The agreement between the two clubs was that Soweto Giants would be entitled to 80% of the transfer fees for Sizwe Khumalo, who is one of the best strikers of Moroka Eagles. This meant that when Moroka Eagles eventually transferred Sizwe Khumalo to another club, Soweto Giants would be entitled to 80% of the transfer fees from the transfer. Soweto Giants speculated that the transfer fees for Sizwe Khumalo would be much higher in the following years and they could make a significant gain from this investment. Sizwe Khumalo was signed by Moroka Eagles after he was transferred from Pretoria Celtics Football Club and the transfer fees were R900 000.

The amount raised by Moroka Eagles from Soweto Giants was not sufficient to restore the club to a sound financial position. The club therefore entered into another similar scheme with a known businessman of the local community, Mr Mabuza. In terms of the agreement between Moroka Eagles and Mr Mabuza, the rights of two club players were ceded to Mr Mabuza. This meant that Mr Mabuza would receive 100% of the future transfer fees when these two players were transferred. The amount provided by Mr Mabuza was R1 000 000 for each player. This was not the first time Mr Mabuza had entered into a similar arrangement with the club. Both ceded players had joined Moroka Eagles from the academy and there were no transfer fees payable when they were acquired from the B team of Moroka Eagles.

A year later, the market value of most of the club's players had increased considerably after the club won the Bluebank Cup, which is one of the biggest competitions of the South African League. The ceded players performed outstandingly during the tournament, which increased the demand for these players by other clubs. The investors, being the Soweto Giants, pressured the Moroka Eagles and Mr Mabuza to transfer the three players before their contracts expired. Moroka Eagles had also received offers with respect to these players. Eventually, the club transferred Sizwe Khumalo before the termination of his contract to a club in Spain (outside South Africa). The transfer fees of such player rights amounted to R3 800 000.

In addition, the other two players who had been ceded to Mr Mabuza were also transferred to other local clubs. The transfer fees in respect of both players were R1 300 000 each.

### **8.5.2 Cession of future transfer fees**

The transfer fees would be subject to income tax in the hands of the club or person who is unconditionally entitled to them or who benefitted by receiving them (*Geldenhuis v CIR*, 14 SATC 419). In most cases, the transferor club has an entitlement to the transfer fees, in which case the transfer fees will be taxed in the hands of the transferor club. However, in certain instances, the

player rights would have been sold, either partially or completely, to an investor while the player is still registered with that club and is being used by it. This is referred to as "third party ownership" of player rights, which means that the transferor club would have ceded the future right to receive the transfer fee in respect of that particular player. In such an instance, the transfer fees would be subject to income tax in the hands of the investor when the player rights are eventually transferred to the other club or other investor. This is provided that there was a proper contractual arrangement between the investor and the transferor club to cede the transfer fees. This arrangement must have been entered into prior to the player rights having been transferred to the other club. This principle came from *CIR v Witwatersrand Association of Racing Clubs*, 23 SATC 380.

In *CIR v Witwatersrand Association of Racing Clubs*, 23 SATC 380, the court dealt with a situation of amounts being received by a taxpayer for its own benefits and subsequent ceding to third parties. In this case, the horse racing association organised a horseracing event where the net proceeds from the event were to be distributed to various charity organisations. The court held that:

- the profits from the event were taxable in the hands of the association, as such profits had been received by the association for its benefits
- the liability for tax could have shifted to the charity organisations if there was a contract prior to the event which stipulated that the proceeds would be for the account of the charity organisations and that the association was just an agent.

Based on the *CIR v Witwatersrand Association of Racing Clubs*, 23 SATC 380, it can be concluded that where a club enters into a contractual arrangement where the transfer fees are ceded to the other party, such as an investor, prior to the transfer of the player taking place, the tax liability will shift from the club to a third party.

The cession of player rights to the investor on its own will give rise to the income tax implications. For instance, the receipt of the investor's funds could either be included in the gross income of the club or be subject to capital gains tax, as the cession of the player rights would trigger a "disposal event". In other words, when the player rights are eventually transferred to the other club, the investor would be subject to income tax.

When the rights of the players are ceded to Soweto Giants and to Mr Mabuza, there will be income tax implications for Moroka Eagles. There is the total amount which is R3 500 000 in respect of the three players ceded, being the R2 000 000 from Mr Mabuza and R1 500 000 from Soweto Giants. From the facts of the case study, it does not seem that the intention of Moroka Eagles had changed. The capital gain will therefore be determined as follows:



	ZAR		
	Sizwe Khumalo	The other two players	Total
Proceeds	1 500 000	2 000 000	3 500 000
Less: Base cost*	(720 000)	-	(720 000)
Capital gain	780 000	2 000 000	2 780 000

\*The base cost represents 80% of the R900 000

### 8.5.3 Actual transfer of players' registrations – Moroka Eagles

Owing to the fact that the transfer fees had been ceded, the portion of the transfer fees that was ceded would not be taxed in the hands of Moroka Eagles. In the situation of Sizwe Khumalo being transferred to a club in Spain, 20% of the transfer fees will still be taxed in the hands of Moroka Eagles, since the amount portion is still received by Moroka for its own benefit. The 20% of transfer fees would be subject to income tax in the hands of Moroka Eagles. No amount will be taxable in the hands of Moroka Eagles in respect of the two players whose rights were ceded to Mr Mabuza. The full amount would be subject to tax in the hands of Mr Mabuza, since 100% of the transfer fees had already been ceded. The capital gain in respect of Sizwe Khumalo for Moroka Eagles will be as follows:

	ZAR
Proceeds in respect of Sizwe Khumalo (20% of R3 800 000)	760 000
Base cost in respect of Sizwe Khumalo (20% of R900 000)	(180 000)
Capital gain	580 000

### 8.5.4 Income tax implications for Soweto Giants

Soweto Giants acquired the future claim of the transfer fees in respect of the transfer of Sizwe Khumalo. The actual expenditure incurred in respect of the cession of the future rights to receive the transfer fees will be allowed as a deduction because Soweto Giants is not acquiring the player to use the player in its matches, thus not obtaining an enduring benefit. It seems that this transaction was entered into with a speculative motive of making a gain. The amount will constitute expenditure of revenue nature and will be deductible under section 11(a) of the Act.

When the player rights are transferred, 80% of the transfer fees will be included in gross income. The amount to be included in the gross income will be R3 040 000.

The cession of player transfer fees should be distinguished from the providing of player rights as security for debt. For example, a club may enter into an agreement with a lender where it is agreed that the lender will provide finance to the club and the future transfer fees will be used as security should the club fail to pay the lender the agreed amount at the agreed time. In terms of paragraph 11(2)(a) of the Eighth Schedule of the Act, the transfer of an asset as security for debt does not give rise to a disposal as defined in the Eighth Schedule of the Act.

## 9. CONCLUSION

For the transferor club, the intention of a club seems to be the deciding factor in determining whether transfer fees are revenue or capital in nature. This therefore means that where a club has entered into a scheme of acquiring player rights and disposing such rights at a profit, such a club would have to include the transfer fees in the gross income. However, since intention is very subjective, the other objective factors, such as the length of the holding period, would have to be taken into consideration. If it were determined that the transfer fees were revenue in nature for the transferor club, then the transfer fees would be included in the gross income. If, on the other hand, the transfer fees were determined to be capital in nature, the transfer fees would be subject to the capital gains tax provided there is a disposal of an asset at proceeds greater than the base cost.

For the transferee club, transfer fees are most likely to be capital in nature based on the facts that:

- the expenditure is incurred to bring an enduring benefit, and
- the expenditure is closely connected to the income-earning asset rather than the income-earning activities of the transferee club.

The transfer fees would therefore not be deductible under s 11(a) of the Act, and the transferee clubs would claim only the transfer fees as part of the "base cost" in determining the capital gains tax when the player rights are eventually transferred to other clubs.

It is recommended that SARS consider publishing a detailed guide on the taxation of some of the transactions that are unique to the sports industry. This will greatly assist the sports clubs and players in understanding the tax treatment of some of the transactions that are only applicable to the sports industry. In finalising this guide, it is recommended that SARS should allow the tax specialists in the field of sports and perhaps sports bodies and clubs to give their inputs and comments. It is believed that this study will assist SARS greatly in drafting a comprehensive guide on the tax treatment of transfer fees.

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