

GSLTR

Global Sports Law and Taxation Reports

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France: Taxation of individual sportspersons

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Switzerland:

Where to go with athletes' tax optimisation after the crack down on the license box model?

Possibilities of structuring athletes' tax in Switzerland

by Dr. Thilo Pachmann & Thomas Wehrli¹

Introduction

The optimisation of the tax burden of athletes is not unknown in the sports industry. Due to their very particular situation, there are various possibilities to consider and special challenges to face. An athlete often faces cross-border situations and is, therefore, subject to taxation in several countries.

Income from sport (prize money, starting fee, salary) is usually taxed at the place of the competition or the work place.² In contrast, royalty income is usually taxed at the beneficiary's domicile. Hence, a common way for athletes to reduce their tax burden is to use an interposed company in a jurisdiction with beneficial tax rates.³ The athlete transfers his intellectual property rights (mostly image rights and trademarks⁴) to this company. The interposed company exploits the transferred IP rights by licencing the IP rights of the athlete to sponsors or the athlete's employer. The employer then splits the athlete's remuneration into direct salary payments to the athlete, including social security charges, and royalty payments free of social security charges payable to the interposed company. The athlete and the employer, therefore, will not pay social security charges on the royalties.

The company can capitalize some of the income and only reimburse a fixed compensation to the athlete in order to control the athlete's personal income and tax situation. The company and the athlete will be taxed on their profit and income in the applicable jurisdiction and the athlete can control the movement of money inflow from the

interposed company. Logically, these interposed companies are set up in jurisdictions which offer favourable tax rates.

Such structures sometimes face resistance by tax authorities, if the athlete is only employed by one employer and the interposed company only licences image rights to this employer. The tax authorities might classify the total remuneration as salary and basis for social security charges. To foster the acceptance, it is recommended that:

- 1 the interposed company is not completely owned by the athlete;
- 2 the interposed company licenses image rights to more than one counterparty;
- 3 the interposed company exploits image rights of more than one athlete; and
- 4 the company has substance⁵ at the companies' domicile⁶.

However, if the athlete is not directly employed by one employer (e.g. tennis player, golfer, etc.), tax authorities for the most accept the structure.⁷

The license box model...

In Europe, thirteen jurisdictions offer preferential tax rates for companies generating income from intellectual property. The main reason to incentivise companies is to retain and commercialize existing patents and to develop new and innovative patented products.⁸ In different jurisdictions, different types of income from intellectual

property qualify for preferential taxation. For example, income from licensing secret formulas or processes only benefit from preferential taxation in Cyprus, Hungary, Spain and Nidwalden, Switzerland.⁹ However, royalty income from patents is included in all thirteen jurisdictions in the qualifying income from intellectual property. The widest scope of qualified income is offered in Switzerland (Nidwalden), Cyprus, Hungary, Liechtenstein and Luxembourg. The latter allows preferential taxation of licensing income from designs, models, trademarks and copyrights.¹⁰

Figure 1 compares the IP box tax rates offered in Europe.

In the athlete's case, the most important aspect is the type of intellectual property that qualifies for a reduced tax rate. Image rights and trademarks need to be included in the qualifying income. Furthermore, the success depends on the possibility of claiming back withholding taxes on dividends and royalties.¹²

In Nidwalden (Switzerland), the athlete's image rights fall under the scope of the qualifying intellectual property rights, enabling the taxation at the tax rate of 8.84%.¹³ Additionally, Switzerland has over 100 double taxation treaties in place, 41 of which comply with the OECD standards.¹⁴

...and its development

In 1998, the OECD produced a report about harmful tax competition,¹⁵ identify-

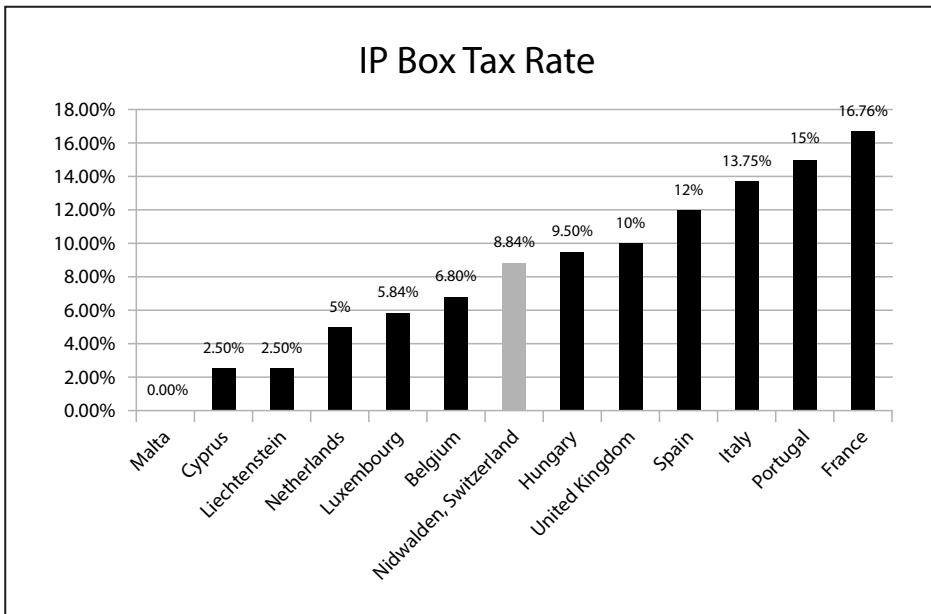


Figure 1. IP box regimes in Europe – IP box tax rates.¹¹

ing a global trend of countries granting an increasing number of tax incentives. The OECD concluded that this development was leading to a tax competition between countries where the tax rate would drift towards 0%. The OECD states that tax optimisation – particularly of multi-national companies – is harmful for governments, individual tax payers and businesses. Therefore, OECD plans wide-ranging actions against profit shifting.¹⁶

An identified tendency emerged where companies tried to associate more profits with intangible rights and obligations. Using complicated legal constructs, income from intangible rights was legally shifted to low tax countries.¹⁷ The OECD is planning to implement measures to curb the possible tax reductions received for intellectual property income by imposing stringent requirements on intellectual property being treated preferentially. The two main limitation factors for receiving tax benefits under the new OECD approach are:

- 1 the requirement of substantial activity of the company requesting tax benefits; and
- 2 the requirement for intellectual property qualifying for tax benefits being a patent, or other IP that is functionally equivalent, that can be legally protected and is subject to similar approval and registration processes.¹⁸

Explicitly excluded from receiving benefits are marketing-related IP assets, such as trademarks or image rights.¹⁹ This implies that athletes will no longer be able

to profit from special IP box tax rates and would need to use normal taxed companies instead.

However, for the structuring and planning of an athlete's income, using interposed companies for licensing image rights can still be recommended. For newly set up companies, the jurisdiction with a favourable ordinary tax rate should be used. Additional factors should also be considered when choosing a new domicile, for example, political stability, low inflation, beneficial legislation or cooperation with other countries.

Possibilities in Switzerland

Switzerland has been known to offer attractive tax conditions for individuals and

companies. It is no coincidence that many international top athletes, for example, the top four French tennis players, cyclists or Formula 1 drivers²⁰, live in Switzerland.

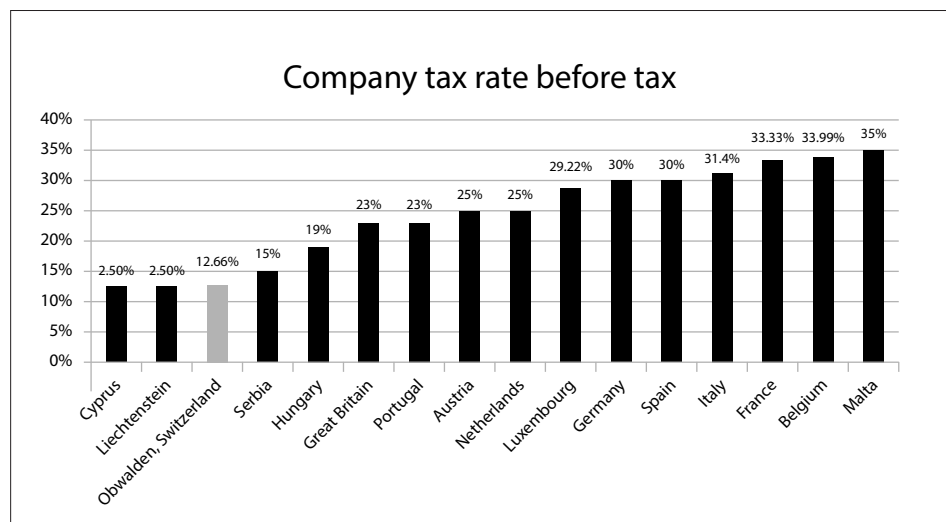
An individual or entity is liable to tax by reason of his domicile, residence, place of management or similar criteria. Switzerland taxes its residents and companies on a federal, cantonal and communal level. Whereas corporation profit taxes are a flat tax, almost all individual taxes are progressive.²¹ There are two main options on how to optimize taxes of athletes in Switzerland. The first option is to use the model of the interposed company; next to attractive tax rates, the companies find attractive conditions for hiring employees. The second option is for the athlete to become a resident of Switzerland and be lump-sum taxed.

Taxation of companies

In nearly all Swiss cantons, companies are subject to corporate income tax and tax on equity.²² Federal tax is always 7.83% on profit before tax. Equity is not taxed at federal level. Each canton and community can define their own tax rates. The tax on equity is usually below 2%.²³ The tax on equity is so low that it does not substantially influence location decisions.

An IP box company domiciled in Nidwalden, Switzerland is taxed at 8.84% on profit before tax²⁴ for their profit generated through licensing. Expenses, for example the regular payments to the athlete for the transfer of the license, can be deducted from taxable profit. However, the preferential treatment of image rights income will – notwithstanding any material

Figure 2. Tax rate before taxes of selected countries.²⁶



changes – end worldwide starting in 2016. In the transition period, this tax rate is still applicable for taxing athletes' IP rights structured through such a company.

However, these developments are favourable for Switzerland. Companies in Switzerland taxed at ordinary rates offer attractive tax rates. In Obwalden, Switzerland, the total tax rate on profit before tax including federal, cantonal and communal tax is 12.66%²⁵ and, therefore, still attractive to implement the above described model of licensing IP rights to an interposed company. The comparison of taxes seen in figure 2 shows the attractiveness of this tax rate.

Additionally, in the next years, a revision of the Swiss corporate tax system is planned, where it is expected that tax rates, especially on cantonal level, will decrease.²⁷

Swiss companies generating over CHF 100,000 revenues in one year are subject to value added tax (VAT) in the amount of 8%.²⁸ However, cross border endorsement contracts or image rights licenses are not subject to Swiss VAT.

Switzerland applies withholding tax of 35% on interest and dividend payments.²⁹ For non-residents living in a country with a double taxation treaty with Switzerland, the withholding tax can be reduced to 0%.³⁰ If the athlete is the owner of the company and wants to pay out dividends, the applicable double taxation treaty needs to be taken into account.

Switzerland is also attractive for companies employing athletes either directly or as independent contractors. This is particularly the case if the athletes compete worldwide and are not required to be in a certain place.³¹ Next to relatively low tax rates, Switzerland also offers affordable social security charges and a secure social security system. The surcharges for social security are approximately 15% for the employer, depending on the age of the employee.³² As an additional benefit, Switzerland offers employer-friendly labour law.

Taxation of individuals in Switzerland

A non-resident is subject to Swiss tax if the individual performs, self-employed or as employee, any professional activity in Switzerland.³³ However, to use an attrac-

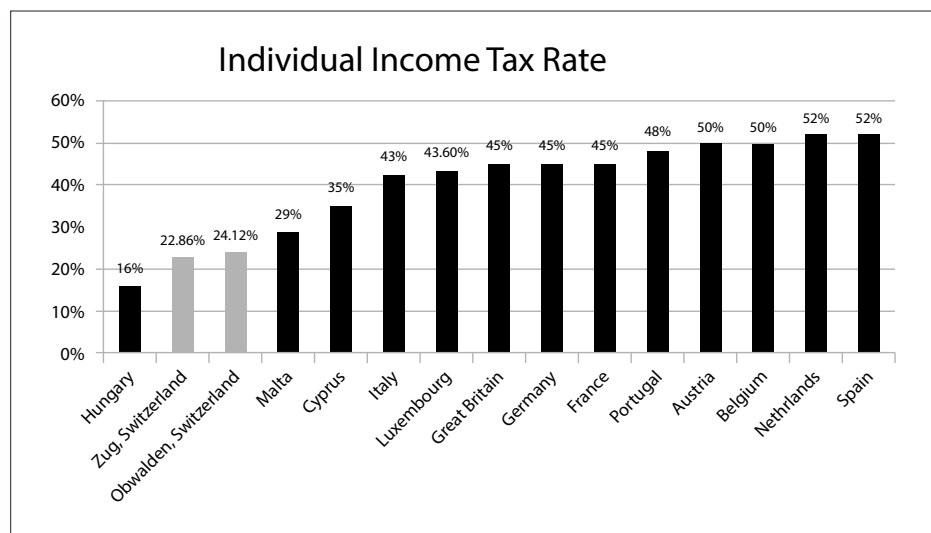


Figure 3. Highest income tax rates of selected countries.³⁹

tive tax solution for athletes, it is necessary to become a resident of Switzerland.

If the following conditions are met, Switzerland offers a lump-sum taxation regime (*“taxation on expenses”*), which can be a very attractive option for athletes³⁴:

- the athlete does not have Swiss citizenship;
- the athlete takes up residence in Switzerland for the first time or re-establishes residence in Switzerland after a non-residency period of at least ten years and establishes a tax domicile in Switzerland;
- the athlete is not gainfully employed or self-employed in Switzerland.

The Swiss lump-sum taxation is not based on the worldwide income and net wealth, but the larger of the annual cost of their living expenses or the income from Swiss sources. By way of simplification, the living expenses are estimated on the basis of rent or rental value (in case of ownership) and estimated to be seven times the annual rent.³⁵ The income of Swiss sources can only be capital income. Allowed Swiss income includes income from financial assets invested in Switzerland, pension from Swiss sources and income from real estate or intellectual property rights exploited in Switzerland. The lump-sum taxed athlete can, therefore, not work in Switzerland, meaning not take part in any competitions connected with his sport, being a coach or not take part in sponsoring events taking place in Switzerland. Under no circumstances is the athlete allowed to have employment income from Swiss sources. If the tax basis decreases, the athlete can abandon the lump-sum taxation.

Certain jurisdictions do not accept taxation based on expenses. In order to benefit from the double taxation treaty with such countries, the athlete has to declare in Switzerland all income from sources within the relevant treaty state (so called modified lump-sum taxation).³⁶ As a consequence, all income from that jurisdiction is ordinarily taxed at the lower Swiss tax rate and the remaining tax burden is calculated based on the expenses.³⁷

The calculated living expenses are the basis of applying the normal tax rate applicable at the domicile of the athlete. The tax rate varies between cantons. For example, if the estimated living expenses amount to CHF 400,000, the total federal, cantonal and communal taxes payable in Zug, Switzerland for the athlete amount to CHF 85,401 or 21.4%.³⁸ Figure 3 shows the attractiveness of income taxation in Switzerland.

Being lump-sum taxed in Switzerland is, therefore, attractive for athletes who compete internationally and are not employed in Switzerland, for example, tennis players, golf players or Formula 1 drivers.

If the athlete is also employed or self-employed and residing in Switzerland – for the most meaning he is competing in Switzerland – the athlete is taxed in Switzerland on his world-wide income.⁴⁰ The tax rate is the same as for the lump-sum tax. As a professional athlete, the athlete would be self-employed, resulting in the athlete being required to pay additionally 9.7% social security charges on world-wide income and 8% VAT on services performed in Switzerland.⁴¹

Conclusion

In the light of the probable abolition of special tax regimes for image rights, this is the time to reassess the athletes' tax situation.

Athletes owning interposed companies being taxed at a preferential IP rate should analyse the potential tax burden after the abolition and compare it to other options.

In international comparison, Switzerland already offers very competitive tax rates for ordinarily taxed Swiss companies and could be one of the next domiciles for athletes' IP companies. However, to avoid adverse tax consequences, the transfer of IP rights should be carefully planned and executed.

Additionally, athletes who are not yet Swiss residents and who do not compete

in Switzerland, should consider the advantages from the Swiss lump-sum tax regime. Even athletes, who perform business and are fully taxed in Switzerland, find an attractive tax situation in Switzerland.

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² As outlined in the OECD double taxation treaty model convention, art. 17.

³ See also Morreau, "France: The use of a foreign interposed company by sports persons", in: *GSLTR 2014/2*, at 36ff. Morreau describes the form generally observed in France but the logic can be applied internationally.

⁴ For example, "ROGER FEDERER" is a registered trademark.

⁵ For example, the company should be managed locally and should have employees in the country of residence.

⁶ Morreau (2014) 38.

⁷ See US court decision *Garcia v. Commissioner*, 140 T.C. 141, 2013. Pro golfer Sergio Garcia, resident of Switzerland, was not taxed in the United States of America on a part of his royalty income. Using a Swiss company and applying the existing double taxation agreement between the United States of America and Switzerland, the U.S. court decided that royalties derived and beneficially owned by a resident of Switzerland could only be taxed in Switzerland. Additionally, the IRS position that all endorsement income should be taxed at ordinary rates (due to being a personal service) without the possibility of using a double taxation agreement was successfully challenged by Garcia.

⁸ Sanz-Gómez, "The OECD's Nexus Approach to IP Boxes: A European Union Law Perspective (2015)", in: *WU International Taxation Research Paper Series No. 2015-12*. Available at SSRN: <http://ssrn.com/abstract=2589065>.

⁹ Evers, Miller, Spengel, "Intellectual property box regimes: effective tax rates and tax policy considerations", in: *International Tax and Public Finance*, Volume 22, Issue 3 (2015) 508.

¹⁰ Evers, Miller, Spengel (2015) 507f.

¹¹ Own design, based on Evers, Miller, Spengel (2015) 513.

¹² Often, royalty payments are subject to withholding tax. In the proposed structure, both the interposed company and the athlete will receive royalty payments for transferring the athlete's image rights. In cross-border situations, double taxation treaties allow a claim back of paid with-

holding tax and, therefore, can reduce the final tax charge. Not all countries apply withholding taxes on royalty payments. For example, in Luxembourg and Switzerland, the payment of royalties is tax free. The same principle applies for dividend payments. If the interposed company belongs to the athlete, he needs to confirm that withholding tax on dividends can be claimed back under the applicable double taxation agreement.

¹³ Art. 85 Abs. 3 Tax Law Nidwalden (hereafter TLN, 521.1), §57a Abs. 2 Tax Decree Nidwalden (521.11).

¹⁴ For a complete list of double taxation agreements signed by Switzerland see www.sif.admin.ch/sif/de/home/themen/internationale-steuerpolitik/doppelbesteuerung-und-amtsilfe.html (accessed 3 August 2015).

¹⁵ OECD, *Harmful tax competition* (1998) 34.

¹⁶ OECD, *Action Plan on Base Erosion and Profit Shifting* (2013a) 13ff.

¹⁷ OECD, *Addressing Base Erosion and Profit Shifting* (2013b) 45. For an overview over identified structuring possibilities which are potentially harmful see 73-81.

¹⁸ OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, OECD/G20 Base Erosion and Profit Shifting Project* (2014) 28-31.

¹⁹ OECD, *Action 5: Agreement on Modified Nexus Approach for IP Regimes, OECD/G20 Base Erosion and Profit Shifting Project* (2015) 5.

²⁰ For example: tennis players Gilles Simon, Jo-Wilfried Tsonga, Richard Gasquet and Gael Monfils; cyclists Jan Ullrich, Marcus Burghardt; Formula 1 drivers Fernando Alonso, Michael Schumacher.

²¹ The canton of Obwalden offers a flat income tax for individuals.

²² Federal Department of Finance, *Federal, Cantonal and Communal Taxes* (2015) 23.

²³ Federal Department of Finance (2015) 50.

²⁴ Art. 68 Federal Law on Direct Federal Taxes, hereafter DFTL (SR 642.11), art. 85 Abs. 1 Tax Law Nidwalden Abs. 3 TLN.

²⁵ Art. 68 DFTL, art. 87 Tax Law Obwalden (hereafter TLO, 641.4). In Obwalden, equity is taxed at a tax rate of 0.2%, art. 98 TLO.

²⁶ KPMG, *Tax Report 2014* (2014) 9f.

²⁷ Eidgenössisches Finanzdepartement, *Massnahmen zur Stärkung der steuerlichen Wettbewerbsfähigkeit (Unternehmenssteuerreform III)* (2013) 4, 53.

²⁸ Art. 8 Value Added Tax Law (hereafter VATL, SR 641.20), art. 10 Abs. 2 lit. a VATL, art. 25 VATL.

²⁹ Art. 4 and art. 13 Abs. 1 lit. a Withholding Tax Law (hereafter WHTL, SR 642.21).

³⁰ At the moment, Switzerland has 41 double taxation treaties according to the OECD model agreement in force. See Federal Department of Finance (2015) 8ff.

³¹ For example, cycling teams.

³² Bundesamt für Sozialversicherungen, *Ratgeber Sozialversicherungen* (2015) 11.

³³ Art. 5 Abs. 1 DFTL, art. 4 Abs. 2 lit. a Federal Law on Harmonization of the Direct Taxes of Cantons and Municipalities (hereafter FTHL, SR 642.14)

³⁴ Art. 14 DFTL, art. 6 FTHL.

³⁵ Art. 6 Abs. 3 FTHL. However, not all cantons offer the possibility of lump-sum taxation. Additionally, cantons have different rules regarding minimum amounts. For example in Obwalden, the minimal taxable amount on cantonal level is five times the annual rent. Starting in 2016, on federal level, the minimum taxed income is CHF 400,000. See www.parlament.ch/d/suche/seiten/geschaeft.aspx?gesch_id=20110043 (accessed 13 June 2015).

³⁶ Art. 14 Abs. 4 DFTL, art. 6 Abs. 7 FTHL. ESTV, *Kreisschreiben Nr. 9 über Verordnung über die Besteuerung nach dem Aufwand bei der direkten Bundessteuer* (1993) 7.

³⁷ At the moment, double taxation treaties with Austria, Belgium, Canada, Germany, Italy, Norway and USA provide for the modified lump-sum taxation.

³⁸ Art. 36 DFTL, §35 StG Zug (hereafter TLZ, 632.1). Tax rates of municipalities in Zug, available at www.zg.ch/behoerden/finanzdirektion/steuerverwaltung/steuerfuss/downloads/steuerfuesse-2015.pdf/download (accessed 29 July 2015).

³⁹ KPMG (2014) 25f.

⁴⁰ Art. 3 Abs. 1 DFTL.

⁴¹ Bundesamt für Sozialversicherungen, *Ratgeber Sozialversicherungen* (2015) 11. Art. 10 VATL.