# An Analysis of Income Tax Implications from the Transfer of Soccer Players

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## Abstract

*Sports clubs often trade in players with each other through the player transfer system. Using the doctrinal research methodology, the study aims at providing an interpretative analysis of the income tax implications from 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. The research methodology used is the doctrinal research methodology which involved an extended review of literature. This article concludes whether the transfer fees arising from the transfer of soccer players should be included in the gross income or be subject to capital gains tax in determining the taxable income of the transferor club. In addition, the study also determines whether the transferee club can deduct the transfer fees in respect of the transfer fees paid in acquisition of player rights under s 11(a) of the Act.*

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

### *Introduction*

The objective of this article is to provide an interpretative analysis of how the transfer fees arising from the transfer of professional soccer players between professional soccer clubs should be subject to income tax in South Africa. This analysis has been based on the Income Tax Act 58 of 1962as amended (South Africa, 1962) (hereafter "the Act" – to which all other unreferenced section references also refer)as it existed at 31 May 2013 and the 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. 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 only be analysed from the perspective of persons who are not natural persons.

Firstly, this article discusses the process of player transfer domestically and internationally as provided in the rules and regulations governing the soccer player transfers. Secondly, this article analyses the "Draft guide on taxation of the sports clubs and players" (hereafter the Guide) as issued by the South African Revenue Service (hereafter SARS). Thirdly, income tax implications are discussed from the perspective of the transferor clubs, based on the Act and the case law. Lastly, the article discusses the income tax implications arising from the transfer of professional players from the perspective of the transferee clubs.

### *Methodology*

This study is an interpretative analysis of the tax law and other literature regarding 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. The research methodology that is used is therefore a doctrinal research methodology. Hutchinison and Duncan (2012) describe doctrinal research methodology as "provid[ing] a systematic exposition of the rules governing a particular legal category, analyses of relationship between rules, explain[ing] areas of difficult and perhaps predict[ing] future developments". This method involves an extended literature study of secondary sources.

## *Background and Explanation of the Player Transfer System*

Fèdèration Internationale de Football Association (hereafter FIFA) is the top soccer governing body in the world which 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) have been issued in order 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. In South Africa, the South African Football Association (hereafter SAFA), which is a member of FIFA, has also issued the regulations on the status and transfer of players (hereafter SAFA Regulations) (SAFA, n.d.). These regulations are only applicable to the members of SAFA, such as the National Soccer League (hereafter NSL) which is affiliate and special member of SAFA. The NSL on the other hand, also has its own rules governing the transfer of soccer players (NSL, 2011). Under the NSL, there are two leagues, namely, the Premier Division League, which is the first tier and the National First Division which is the second tier.

FIFA, SAFA and NSL require that soccer players, whether professional (those players who are remunerated for participating in soccer) or amateurs (those players not remunerated for playing soccer) must be registered with the relevant association in 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 participates in its leagues. Players are also required to enter into professional contracts with the clubs which they play for. The duration of such contracts cannot exceed three years in case of minor players, and cannot exceed five years in case of adult players.

The regulations prohibit the registration of a player with 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 registration will therefore have an exclusive right to use the player in the tournaments. This right can be transferred to the other clubs within the same national association or the national associations of the other countries. Where a player is still contracted, meaning the player's contract has not terminated, a transferor club may charge a fee for the transfer. This fee is referred to as "transfer fee". The transferor club may also choose to transfer a player for free or to loan a player to the other club. The scope of this article excludes the loaning of players. Where the player's contract has terminated, the player will be allowed to change registration to any other club without the transfer fee being payable, as the player will be regarded as a free agent.

Free agents can register anytime during the soccer season, however, the players who are still contracted to other clubs who transfer to other club can only transfer during the transfer window period. This period runs from 01 July to 31 August of every year, and again from 01 January to 31 January (NSL, 2011: art 26.6.1 & 26.6.2). This therefore restricts the transfer of contracted players between clubs to only take place during the transfer window.

The process of player transfer will have 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. The negotiations between the player and the transferee clubs will also take place. Players are usually represented by their agents in these negotiations. The transferor and transferee clubs will then negotiate the transfer fees. An application will therefore be 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 will be effected. It is at this stage that a player can then play in the team for the transferee club.

In case of international transfer, i.e. the transfer involving national associations of two different countries, the FIFA Regulations must be followed. In terms of these regulations, the transfer process must be done through a system known as Transfer Matching System. A transferor national association must issue a clearance certificate to the transferee national association. Only once this clearance certificate has been received the transferee national association will be able to register the player under the transferee club.

### *The Draft Guide on the Taxation of Sports Clubs and Players*

In 2010, the SARS issued the Guide (SARS, 2010a) in a draft format. At the time of the writing of this article, the Guide had not been finalised. 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. Amongst the topics, it also specifically addresses the taxation of transactions that arise from the transferring of players between sports clubs.

In dealing with the transactions relating to the transfer of players between clubs, the Guide states that the transfer fees arising from the transfer of a player would be regarded as capital and subject to capital gains tax on the following basis:

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

The Guide also states that if it can be clearly seen that the club has entered into a profit-making scheme and is holding players for speculative purposes, then the transfer fees would be included in gross income (ibid. at p6).

The Guide further states that 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 capital in nature (ibid. at p5).

The problems with this Guide are as follows:

- Firstly, the Guide is incomprehensive and the statements are not supported by the relevant case law, specifically the case law dealing with gross income and the general deduction formula. The author of the Guide has acknowledged in the foreword of the Guide that: “this guide is not meant to delve into the precise technical and legal detail that is often associated with taxation and should not be used as legal reference” (SARS, 2010a). It is therefore the aim of this study to analyse the relevant case law in determining whether the conclusions reached by the Guide are correct;

- Secondly, the Guide deals with sports in general and covers a wide range of other issues; therefore not enough research has been conducted regarding the rules and regulations governing the transfer of players between clubs, with more specific focus on soccer, as different sporting codes have different rules and regulations governing the transfer of players. The rules and regulations of soccer bodies as they apply to the transfer of players will be studied in order to ensure that the income tax implications are analysed from the view of every possible scenario of player transfer that currently exists. For instance, the Guide does not discuss the implications arising when there are player swops and when there is third party ownership of players;

- Thirdly, the Guide has only focused on whether the transfer fees are revenue or capital in nature and has failed to discuss other components in relation to “gross income” definition per s 1 of the Act, or other elements relevant for the capital gains tax purposes; and

- Finally, the scope of the Guide is only limited to transaction between residents and has not considered the income tax implications that may arise where the resident clubs transact in players with non-resident clubs.

In the 2012 annual seminar on tax law in the sports industry hosted by Edward Nathan Sonnerbergs (hereafter ENS), the participants (accountants and financial managers of various clubs from different sporting bodies were also participants) suggested that the “taxation of the player transfer fees” should be one of the topics they would like the seminar to address (Parker, 2012). This clearly indicates that the tax implications of the transfer fees remain a concern for most people in sports. This also indicates that people in sports are either not aware about this Guide, or the Guide is not clear or comprehensive enough.

The seminar referred, in dealing with the income tax implication arising from the transfer of players, noted the existence of the Guide in its draft format (ENS, 2012). The income tax implications in respect of transfer fees were discussed at the seminar as presented in the Guide. However, the seminar did criticise the Guide for not providing clarity on what the income tax implications are in the case of free transfers of players (id.). The seminar concluded that this area still needs to be confirmed with SARS. In addition, based on the power point slides from the presentation, there was no indication that the transfer fees could be revenue in nature, and therefore be included in gross income (id.).

The power point slides are therefore in support of the transfer fees being capital in nature (id.). There seems to be confusion to the clubs as to whether the transfer fees could be included in gross income for the transferor club, and if so, under what circumstances will this be the case. There is also confusion as to whether the transfer fees could be deductible in determining the taxable income of the transferee club under the Act.

Parker (2012) notes the shortage of the academic literature devoted to tax in sports industry. This study will therefore add in building up the scholarly literature in the field of sports tax. In addition, the study will assist the sports clubs in determining the income tax implications arising from transfer of players, as it provides a comprehensive analysis of the income tax from the player transfer transactions.

## *Taxability of Professional Soccer Clubs in South Africa*

In South Africa, receipts and accruals of the recreational clubs are exempt from income tax in terms of s 10(1)(cO) of the Act, provided they apply to 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 profit-making is the intention of the professional soccer clubs. As a consequence, the professional soccer clubs do not meet the definition of the "recreational club" as their object is not just to provide social and recreational amenities or facilities, but also to make 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 recreational clubs.

## *Income Tax Implications for the Transferor Clubs*

The transferor club receives transfer fees for the disposal of the player rights. The transfer fees will either be included in gross income in terms of s 1 of the Act or be subject to capital gains tax. The transfer fees will be included in gross income if all the requirements in terms of the definition of "gross income" are met. For transfer fees to be subject to capital gains tax they must be capital in nature and there must be a disposal of an asset where proceeds are greater than the "base cost.

For the purposes of gross income
The definition of "gross income" per s 1 of the Act states 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…"

### 6.0.1. Transaction with non-resident clubs

The South African tax system is a hybrid of residence based taxation and source based taxation. From the definition of "gross income" as stated before, it is clear that "residents" will be taxed on the world-wide income whereas non-residents will be taxed on amounts that are from South African source. Section 1 of the Act defines "resident" in respect of persons other than natural persons, to mean an entity "incorporated, established or formed" or has its "place of effective management" in South Africa.

All clubs registered with the NSL and SAFA will definitely be regarded as "residents" since it is the requirements for becoming members of these associations that the clubs be incorporated in South Africa. This therefore means that the NSL and SAFA clubs will be "residents" as defined. The second part of the definition of "resident" per s 1 of the Act, relating to "place of effective management" is therefore not relevant for clubs registered with the NSL and SAFA.

International transfer of players either involves a player of a resident club being transferred to a club that is not a "resident" as defined in s 1 of the Act or a player of a resident club being transferred to a non-resident club. A resident club will be taxed on the world-wide income whereas a non-resident club would be taxed only on income that is from South African source. In CIR v Lever Brothers & Unilever Ltd, 14 SATC 1, it was established that in determining the source of an amount, it must firstly be established what was the originating cause of such amount, and secondly where such cause is located. In the case of player transfer, the originating cause of the transfer fees is the transfer of the player rights from one club to another club. The transfer of a player rights involves deregistration of a player by the transferor national association and also registration of the player by the transferee national association. These activities are performed in two different countries. As a result, the location of the cause will be based in two jurisdictions. The courts have decided that, in instances where the activities that give rise to income are located in more than one country, then the source will be where the dominant activities are performed (Transvaal Associated Hide and Skin Merchants v Collector of Income Tax Botswana, 29 SATC 97). In case of player transfer, it would be very difficult to determine in which country the dominant activities are performed, especially in the absence of the double tax agreement. The Act does not prescribe the apportionment of the transfer fees, however, the courts have applied the apportionment of income between two jurisdictions (ITC 396, 10 SATC 87 & ITC 1104, 29 SATC 46). This therefore means that the transfer fees must be apportioned between the two jurisdictions. However, where there is a double tax agreement that exists between two countries, then the double tax agreement will determine which country the transfer fees will be subject to tax.

### 6.0.2. Total amount in cash or otherwise

The term "amount" has been interpreted by the courts to mean not just money but everything that has monetary value (Lategan v CIR, 2 SATC 16). In case of barter transactions, the market value of the property received must be included in gross income or be included in proceeds for the purposes of the capital gains tax in terms of the Eighth Schedule of the Act (Lace Proprietary Mines Ltd v CIR, 9 SATC 349). The transfer fees will therefore constitute an amount. In case of player swops, where the clubs exchange in player rights, each club will included in its gross income or proceeds, the market value of the player rights being received.

Where a transferor club decides to transfer a player, who is still under contract for free to the other club, then the transferee club is receiving property which has monetary value. In such a case, the market value of the player rights being received will constitute an amount for either gross income or proceeds purposes. However, if a player is regarded as free agent, i.e. not contracted to any club, then there is no market value (or monetary value) for the player rights and therefore no amount. Consequently, there will not be any income tax implications for the transferee club.

### 6.0.3. Received by, or accrued to, or in favor of a taxpayer

The receipt and the accrual of the amount are very important as they determine the timing of when would the amounts be subject to income tax. In addition, the receipt or accrual of the amounts also determines which person will be subject to the income tax. The amount will therefore be subject to income tax at the earlier of receipt or accrual. The courts have interpreted the term "received" to mean received by the taxpayer and for the taxpayer's benefit (Geldenhuys v CIR, 14 SATC 419). A mere receipt of amount does not equate inclusion in gross income. On the other hand, the term "accrued" has been interpreted to mean unconditionally entitled to (Ochberg v CIR, 6 SATC 1 & Mooi v SIR, 34 SATC 1).

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 has a benefit of receiving them. 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 either partially or completely sold to an investor, while the player is still registered with and also being used by that club. This is referred to as "third party ownership" of player rights. This therefore 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 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 prior to the player rights being transferred to the other club.This principle came from CIR v Witwatersrand Association of Racing Clubs, 23 SATC 380.

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 a club or be subject to capital gains tax. For capital gains tax purposes, the cession of the player rights would trigger a "disposal event". So when the player rights are eventually transferred to the other club, the investor would be subject to income tax.

**6.0.4. Not of a capital nature**

The definition of "gross income" per s 1 of the Act excludes amounts of capital in nature. Even though the Act does not define the term "capital", the courts have come with various tests that must be used to distinguish between revenue and capital. These tests are discussed next.

**6.0.4.1. Intention of a taxpayer**

The principle of the "intention of a taxpayer" derived from the Elandsheuwel Farming (Edms) Bpk v SBI, 39 SATC 163,where it was established that the intention of a taxpayer in respect of an asset is at certain instances, a decisive factor in concluding whether an amount is revenue or capital in nature. In this case, it was determined that the intention of a taxpayer must be considered from the time an asset is acquired until the time of sale. On the one hand, where the intention of a taxpayer is to enter into a profit-making scheme, then the proceeds from the sale of the asset would be considered to be revenue in nature and therefore included in gross income. On the other hand, where the intention of a taxpayer was to use the asset to produce income, then the proceeds would be regarded as capital in nature. The problem with the intention test is that it is subjective and one would have to consider other objective factors that support a taxpayer's ipse dixit (what a taxpayer says his intention is).

In the case of the transfer of professional soccer players between professional soccer 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. 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 the tournaments or the 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.

**6.0.4.2. The length of the holding period**

The length of the holding period of an asset is another test used by the courts in determining whether the amounts are revenue or capital in nature. This test, however, should not be used in isolation, but should be applied with other tests in determining whether transfer fees are revenue of capital. The player contracts in soccer are usually for duration of three to five years, depending on whether a player is a minor (in which case the maximum is three) or is an adult (in which case the maximum is five years). Although this is an important test, it is not a decisive test. For instance, a player might have been with a club for four years and when the contract of that player is transferred to the other club, the transfer fees might be regarded as revenue nature because the intention of a club at the time of the transfer of the player was to enter into a profit-making scheme. The opposite is also true where a player might have played for the club for less than one year and gets transferred to the other club due to non-performance, in which case, the transfer fees may still be regarded as being capital in nature.

**6.0.4.3. Tree versus fruit analogy**

The analogy of tree versus fruit derives from CIR v Visser, 8 SATC 271. According to this test the transfer fees from the transfer of a player would be revenue in nature if such right were income-producing. In such a case, the player rights would have been recognised as the "tree" and the income generated through owning such rights would be regarded as "fruit". A single player alone cannot generate income for the club as soccer is a team sport. However, a group of players make up a team, which then generates revenue for the club. The whole team is therefore a tree in terms of the tree versus fruit analogy. The player is then part of the tree. This therefore means that the player rights would be capital. However, the intention of a transferor club must still be taken into consideration at the time of transfer.

#### 6.0.4.4. Fixed versus floating

Floating capital is described as what disappears in the production process, whereas fixed capital does not (CIR v George Forest Timber, 1 SATC 20). In the case of soccer clubs, player rights would generally not be "trading stock". However, if it is determined that the intention of the club has changed and the club has involved itself in a scheme of trading the player rights for profit, then the transfer fees would be regarded as being revenue in nature.

**For the purposes of capital gains tax**

The fact that an amount has been regarded as being capital in nature does not necessarily mean that it will automatically be subject to capital gains tax. There must still be a disposal of an asset where proceeds are greater than the base cost.

### 6.1.1. Asset

An "asset" is widely defined in paragraph 1 of the Eighth Schedule of the Act as:"includ[ing] –

(a) property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum; and
(b) (b) a right or interest of whatever nature to or in such property."

As discussed before, the transferor club is giving up its right to exclusively use the player in its official matches. The right is therefore incorporeal property as it cannot be touched. Two types of rights are recognised, namely, real rights (jus in rem) and personal rights (jus in personam) (SARS, 2011: 38). The difference between real and personal rights is that, whereas real rights are enforceable against the whole world: personal rights are only enforceable against a specific person or group of persons (id.). The right being transferred is therefore a jus in personamasit can only be enforced against a group of persons, i.e. other clubs. The player rights are incorporeal property and do meet the definition of an "asset".

### 6.1.2. Disposal

The change in the ownership gives rise to a disposal in terms of paragraph 12 of the Eighth Schedule of the Act. This therefore means that when the right is being transferred to another club, this will create a disposal event which gives rise to capital gains tax. The timing of disposal is pivotal as it determines the year of assessment in which the capital gains will be subject to income tax. The disposal of an asset will take place at the time when the ownership of an asset changes. If there are any suspensive conditions that must be met before the changes in the ownership of an asset, the disposal will only take place once all the suspensive conditions have been met. The disposal will occur once all the requirements for the player registration with the new club have been completed.

### 6.1.3. Proceeds

In terms of paragraph 35 of the Eighth Schedule of the Act, "proceeds from the disposal of an asset by a person are equal to the amount received by or accrued to,... or in favour of, that person in respect of disposal". This therefore means that the transfer fees, if determined to be capital in nature, would be subject to capital gains tax at the earlier of receipt or accrual. The use of the phrase "in respect of" shows that the disposal and the accrual or receipt must be directly linked (CIR v Crown Mines Ltd, 32 SATC 190). This therefore means that if the receipt of the amount does not coincide with the disposal, the amount will still be included as proceeds irrespective of the fact that the disposal has not taken place.

### 6.1.4. Base costs

Base costs of the player rights would include the acquisition costs of a player (transfer fees), including costs of defending ownership of the player rights as well as the holding costs, such as the costs of developing a player, provided these costs have not been allowed as a deduction in any other section of the Act, and any other costs listed in paragraph 20 of the Eighth Schedule. There will be no acquisition costs in case of players who are developed by the club from internal academies. However, the development costs can be included in the base cost of individual player provided that these have not been allowed as a deduction in the other section of the Act and can be allocated to the individual player.

## *Income Tax Implications for the Transferee Clubs*

**General deduction formula**

For the transferee club that pays a transfer fee, the transfer fees would be regarded deductible under s 11(a) of the Act if the requirements of this section are met. The first requirement, which is the preamble to s 11 of the Act requires a taxpayer to be carrying on a trade before any deduction can be claimed under s 11 of the Act. Section 11(a) of the Act should be read together with s 23(g) of the Act which prohibits the deduction of amounts which are not incurred for the purposes of trade. In Burgess v CIR, 55 SATC 185, it was held that the term "trade" should be interpreted widely to include every profitable activity. The Act also widely defines the term "trade". In therefore goes without saying that the professional clubs would be regarded as carrying on a trade and can therefore claim deductions under s 11.

In terms of s 11(a) of the Act, "expenditure and losses actually incurred in the production of income" can be deducted from income provided such expenditure and losses are not of a capital nature.

**7.0.1. Expenditure and losses**

The transfer fees paid or payable by the transferee club would meet the meaning of "expenditure", which was interpreted in Joffe& Co (Pty) Ltd v CIR, 13 SATC 354, to mean voluntary payments. Also in the more recent case, CSARS v Labat Africa Ltd, 74 SATC 1, it was held that the term "expenditure" should be given its ordinary meaning.

**7.0.2. Actually incurred during the year of assessment**

Transfer fees, if revenue nature, would be deductible only if "actually incurred" during the year of assessment. Actually incurred does not necessarily mean "paid", but it also includes an "undertaking of an obligation to make payment" (Ackermans Ltd v CSARS, 73 SATC 1). It therefore follows that the transfer fees would be "actually incurred" if the obligation to pay has arisen. The obligation to pay will arise once the transfer process has been completed and the player has been registered under the new club.

The transfer fees would be deductible if actually incurred during the year of assessment in which they are incurred. This principle was also confirmed in Concentra (Pty) Ltd v CIR, 12 SATC 95. This therefore means that if a club fails to deduct the transfer fees in the year in which it is incurred, the deduction will be lost forever.

**7.0.3. In the production of income**

In Port Elizabeth Electric Tramway Co Ltd v CIR, 8 SATC 13, it was also established that for the expenditure to be deductible under s 11(a) of the Act, there must be a close connection between what gave rise to the expenditure or losses and the income-producing activities of a taxpayer.

The main activity of soccer clubs is to play soccer. For clubs to perform this activity they need players. Only once the club is able to participate in professional football that it will be able to generate revenue. Spending on acquisition of player rights by the club therefore becomes an integral part of the business of the club. Therefore, the transfer fees in respect of acquisition of player rights are in the production of the club's income, and are directly linked to the club's operations.

**7.0.4. Not of a capital nature**

For transfer fees to be deductible under s 11(a) of the Act, they must be of revenue in nature. The Act makes no distinction between revenue and capital. However, various tests have been used to determine if expenditure and losses are revenue or capital in nature for the purposes of s 11(a). These tests are discussed below in respect of the transfer fees.

**7.0.4.1. Enduring benefit**

The enduring benefit principle was developed in British Insulated and Helsby Cables v Atherton1926 A.C 205. According to this principle, transfer fees would be capital in nature if a transferee club will obtain an advantage for 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 period. 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, tournament prize monies, etc.

In ITC 1063, 27 SATC 57(N), a company formed in South Africa was appointed by another company, which manufactured gramophone records, as a sole distributor of gramophone records in South Africa. The distributor had undertaken to pay R27 000,00 to the manufacturing company in respect of being granted the right of being the sole distributor of the manufacturer's products.

The right was acquired for the duration of three years with the option of renewal for further two years at an option of the distributing company. The Commissioner for Inland Revenue disallowed the deduction on the grounds that the amount was of capital nature. The court held that the amount was indeed capital in nature and therefore not deductible.

The facts of this case are very 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 further two years, and also in soccer, the contract for minors is limited to three years and five years in 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 therefore generate income

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

**7.0.4.2. Once and for all**

According to this test, transfer fees are likely be capital in nature if the expenditure is not repetitive. This principle derived from Vallambrosa Rubber Co v Farmer, SC 519. Transfer fees are likely to be recurring expenditure. It is common of clubs to acquire players during any transfer window period. However, this test cannot be decisive in isolation. It will have to be applied with other tests in order to reach a conclusive decision.

**7.0.4.3. Closeness of connection between income-producing activities**

When expenditure is closely related to the income-producing asset of a taxpayer, then 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. This test also links with the "filling a hole" test, which ask a question of whether expenditure is filling a hole in the profits of a taxpayer, in which case such expenditure would be revenue in nature. However, if the expenditure is incurred in order to fill a hole in the assets of a taxpayer, then the expenditure would be capital in nature.

Soccer players of a club are the assets and infrastructure of the club, therefore the rights to exclusively use the players are indeed the income-earning structure. It therefore follows that the transfer fee is closely connected to income-earning assets of a club, which is similar to filling a hole in the assets of the club. Consequently, the transfer fees would be capital in nature.

## *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 club would have to include the transfer fees in 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 is determined that the transfer fees are revenue in nature for the transferor club, than the transfer fees would be included in gross income. If, on the other hand, the transfer fees are determined to be capital in nature, the transfer fees would be subject to capital gains tax, provided there is a disposal of an asset at proceeds greater than the base cost.

For the transferor club, transfer fees are most likely to be capital in nature for the transferee club based on the facts that (1) the expenditure is incurred in order to bring an advantage for an enduring benefit; and (2) 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. The transferee clubs would therefore only claim 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.

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