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The Manager
Individuals Tax Unit
Individuals and Indirect Tax Division
The Treasury
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PARKES ACT 2600

Attention: Shanyn Sparreboom

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Dear Shanyn

Taxation of income for an individual's fame or image

Chartered Accountants Australia and New Zealand (CAANZ) appreciates the opportunity to comment on the Treasury Consultation Paper Taxation of income for an individual's fame or image (the paper).

Executive summary

CAANZ has a number of concerns and comments about the proposed policy approach to the taxation treatment of an individual's fame or image that was announced in the 2018-19 Budget.

These concerns relate to:

- The over-reliance on personal income tax due to the lack of fundamental tax reform.
- Legislating for specific issues when administrative solutions or enforcement of existing laws could suffice. Making the tax law more complex isn't always necessary.
- The need for greater clarity regarding the personal service and business services divide.
- The scope of the proposal. Whilst it is stated that the target group is footballers, a much larger group of people such as performing artists and social network publishers also face these issues.
- The disconnect between tax law and intellectual property laws which adds to compliance costs.

In relation to the specific proposals outlined in the paper, greater consideration needs to be given to the following issues:

- How such payments will be treated from a capital gains tax perspective.
- Apportionment of payments.
- Likely behavioural responses – particularly from highly mobile individuals.
- Deductions which are associated with such income.
- Ability to enforce and collect tax from non-residents.

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- Income earned by deceased estates and children.

CAANZ recommends further research and policy development work be undertaken.

We recommend deferring the start date from 1 July 2019 to at least 1 July 2020.

Australia's over-reliance on personal income taxation

The paper skates around a key issue fundamental to the policy thinking which underpins our income tax law.

The taxation of personal services income provides the bulk of Australian tax revenue and any attempts to erode this particular tax base have long been countered by both the ATO and the legislature. Put simply, the goal has been to keep as many Australians as possible in the PAYG withholding box even though citizens are finding many new ways to work and earn.

CAANZ and others have questioned this heavy reliance on personal taxation and although this is not an appropriate forum to air our arguments again, the paper is yet another attempt to patch-up an ailing tax system.

The growing divergence between the personal and corporate tax rates has added incentive to those – typically mid to high-income earners – aggrieved by the after-tax outcomes they experience, particularly when their peak lifetime earnings are confined to a brief period of prowess or fame.

The ATO's previous efforts and current thinking

This paper not only follows-up on the Government's 2018-19 Budget proposal, "Tax Integrity — taxation of income for an individual's fame or image", but also reflects an unsuccessful attempt by the ATO to deal with the issue on an administrative basis – refer PCG 2017/D11 (Withdrawn) – Tax treatment of payments for use and exploitation of a professional sportsperson's 'public fame' or 'image'.

Around the time PCG 2017/D11 was published, CAANZ publicly supported the ATO's administrative approach rather than making existing tax law even more complex[1].

The history of this matter is important in that it raises the age-old question about whether the ATO should seek to clarify the taxation issues using existing legislation, its administrative powers and judicial test cases, before resort is had to a legislative solution.

A key question for Treasury and the Australian Government is whether the ATO did all it could to clarify the operation of the *existing* income tax law to image rights companies and trusts. This would include the application of anti-avoidance provisions in the law.

Indeed, the paper states that[2]:

> "Concerns with licensing structures *has led to the ATO revisiting its position on the use of 'image rights' and it no longer considers that licensing arrangements, like those considered in the draft PCG 2017/D11 between high profile individuals and their associated entities, are effective*. The associated entities gain no proprietary or other rights in the individual's fame or image under such licensing agreements and therefore cannot exploit the image rights." [Emphasis added]

[1] Michael Croker, You'll never see my picture on the back of a bus. But here's why I support the ATO's efforts to tackle the taxation of image rights, published on LinkedIn and shared with ATO officials, 24 July 2017.
[2] Refer page 7 of the paper.

If tax-motivated structuring arrangements are now considered ineffective, why have they not been attacked using existing powers entrusted to the Commissioner? Were safe harbour solutions too quickly abandoned by the ATO?

In this regard, parliamentarians would benefit if the paper and Explanatory Memorandum that follows could be more transparent about the ATO's previous efforts and current thinking within the Law Design and Practice Group.

The United Kingdom experience

The ATO's views in PCG 2017/D11 may have been motivated in part by the approach in the United Kingdom, where lengthy negotiations have occurred with football clubs and their advisers. There have been reports in UK tax circles of an agreement in 2015 that allowed clubs to treat up to 20% of the salaries paid to players as a payment for the use of their image rights[3] (the ATO proposed 10%).

Within the ATO, perhaps there was a realisation of the difficulties encountered by overseas tax regulators in dealing with image rights.

The UK media regularly comments on the lengths to which HMRC officials have gone to investigate high profile footballers (soccer players) who have entered into image rights contracts. Even so, the HMRC's compliance and administrative efforts were criticised when the Paradise Papers revealed that some high-profile footballers had used complex structures to exploit image rights.

The UK approach remains largely administrative and there have been a number of relevant judicial decisions[4].

The tax policy challenge

It is intended that the target group in Australia will extend far beyond footballers[5]. Performing artists are another large group concerned about misuse of images[6].

We think it is important for Treasury to further research the scope of this proposal.

The development of social media has created new opportunities to generate income not just by the "rich and famous", but by *anyone* who successfully develops or promote products, services, images, ideas and viewpoints that attract followers prepared to pay, directly or indirectly, for access.

In some cases, the income so generated:

- Is in kind, not money (e.g. gifts of merchandise, invitations to "A list" events, travel which may be difficult for the recipient to value)[7], and \ or

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[3] Pete Hackleton, The current legal status of image rights companies in football, 5 July 2016. Published on Law in Sport website.
[4] Refer HMRC Employment Income Manual.
[5] Refer page 7 of the paper.
[6] Unauthorised use of your image, Information Sheet published by Arts Law Centre of Australia. An artist could (for example) establish a performing arts company to represent his or her interests in dealing with recording companies or screen producers. In some cases, an artist will have collective rights with other performers as well as individual rights.
[7] This raises the spectre of s21 and s21A ITAA 1936. The latter becomes relevant if a non-cash benefit relates directly or indirectly to a business relationship although many tax practitioners would say that s21A is more honoured in the breach than the observance. Where the individual is provided with non-cash benefits by an image rights entity which employs the individual, Fringe Benefits Tax becomes relevant. Where the individual (in the capacity of a

- May flow to the recipient *indirectly* in a way disconnected from mere use of an image (e.g. from advertising revenue generated on the platform where the individual posts items online), and \ or
- Can often be sourced outside Australia, making compliance difficult for the ATO.

Image rights structures

One of main justifications used in the paper for policy change is that[8]:

> "Under this [revised ATO] view, there is generally little or no scope for sportspeople and other individuals to redirect parts of their remuneration in the way that raises integrity concerns. The general principle, based on arrangements commonly engaged in by sportspersons, would extend to other arrangements. However, not all potential structures in use and all circumstances have been reviewed. *Legislative amendments would place this outcome beyond doubt.* The amendments would also provide clarity for payments that are not part of lump sum remuneration arrangements, including where payments are made directly to the related party." [Emphasis added]

CAANZ questions the logic here.

If the ATO is so sure of its revised position, then by now we should have seen evidence of its effective, determined application (e.g. by way of revised guidance, audit programs etc).

Business income borderline – Complex legislative solutions

Image rights are just the latest example of how our tax system struggles to deal with what many Chartered Accountants (CAs) regard as a legitimate commercial differentiation between payment for performance of employment and personal services on the one hand, and *business services* on the other. The latter can be quite broad in this context – such as product endorsement, character merchandising, promotional services.

There other examples of borderline problems.

The differentiation between contractors and their personal services companies have long been an issue for both income tax and payroll tax regulators in Australia and yet no lasting legislative solution is proffered for this more pressing issue which affects a far larger group of citizens.

Professional men and women have experienced numerous ATO interventions over many years targeting the practice structures used to protect personal assets and manage commercial risk.

Personal service income legislative rules exist in the law[9] but necessarily contain several exceptions allowing well-advised individuals to gain self-employed contractor status or establish "personal service entities"[10].

Many taxpayers, their advisers and tax officials are confused as to the borderline between the personal tax system (targeting individual labour) and the business tax system (targeting income generated from capital, investment *and* in some cases, labour). As already noted in *Spriggs v Commissioner of Taxation* [2009] HCA 22, professional sportspeople (and by analogy, other

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shareholder or associate) is provided with private use of an asset belonging to an image rights private company, the operation of Division 7A ITAA 1936 is attracted.

[8] Refer page 7 of the paper.

[9] Refer Division 86 ITAA 1997 and ATO's Working Out If the PSI Rules Apply flowchart.

[10] The ATO's guide to Personal services income for companies, partnerships and trusts runs to 60 pages.

entertainers) derive *both* personal exertion income from employment activities and income from carrying on a business of using their fame or image.

It is difficult to see how the proposed law dealing with image rights won't add further complexity.

ATO guidance

TR 1999/17 makes a modest attempt at addressing the borderline in a sports context.

Paragraphs 25 to 28 deal with income for services provided outside of employment and again raise a question whether the ATO has followed through on the following statement:

> 28. Where a sportsperson is entitled to receive an amount for services rendered and the amount is received by another person on behalf of, or at the direction of the sportsperson the amount is assessable income of the sportsperson (subsection 6-5(4) of the ITAA 1997). Such an amount would include payment to a trustee for the benefit of the sportsperson (refer paragraph 5 of Taxation Ruling IT 2262) or payment to an associate or relative of the sportsperson.

Where are the CGT policy boundaries?

The paper skirts the CGT issues relevant to image rights[11].

It implies that the distinguishing feature in the context is that a person's image is innate – it is not property capable of separate assignment in the sense of the arrangement considered in *FCT v Everett* [1980] HCA 6[12]. Creditors of an insolvent image rights company could not, so the paper argues, take possession of (nor realise any value in) the licence granted to the company.

We are not so sure about this analogy and wonder about the tax policy boundaries, particularly with capital gains tax (CGT)[13].

Knowledge inside a person's head is similarly personal and may not yet have taken legal form as a patent or copyright. It is not a "CGT asset" (property or an interest in property)[14].

But when such knowledge forms the basis of a newly created contractual right however, CGT treatment can apply[15] although the valuation issues which arise[16] are probably seen as a problem within the ATO. Valuation is particularly difficult where there is a bundle of associated rights in the one contract (e.g. contractual rights, image rights, registered trademarks, copyright and goodwill).

The mention of goodwill also raises complex issues about what goodwill means in an Australian CGT context: the ATO view is that 'personal goodwill' or 'name goodwill' are inseparable from business goodwill (i.e. a single CGT asset approach for CGT purposes)[17]. But the recent UK case

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[11] Refer page 12 of the paper.
[12] Refer page 6 of the paper.
[13] According to the paper, CGT "would be expected to be minimal": refer page 12. It would be useful to expand on the reasons why this view is held.
[14] Section 108-5 ITAA 1997.
[15] For example, CGT event D1: s104-35 ITAA 1997. TR 2006/14 states that "a mere personal right which cannot be assigned" attracts CGT event D1 when such a right is granted (refer para 105).
[16] HMRC has grappled with the CGT valuation issue in this context, concluding that "[T]here may be a value to that contractual right if the [image rights] company disposes of it to a third party, but there is no value at the earlier date. when the [football] player grants the right to the company. In Australian CGT law, the market value substitution rule is disapplied for CGT event D1 where there are no capital proceeds at the time rights are created: s116-30(3)(b) ITAA 1997.
[17] TR 1999/16

of Robyn Fenty and others v. Arcadia Group Brands[18] suggests that the protection of an "image right" derives from the passing-off of goodwill belonging, in that case, to the recording and performance artist Rihanna.

CAANZ strongly recommends that the policy outlined in the paper not advance without the ATO also issuing practical guidance on the CGT treatment of entering into an image rights arrangement.

Apportionment problems

The paper envisages that apportionment will apply such that any income generated in an associated entity from image rights will be attributed to the individual.

Complex apportionment issues can arise (on both the income \ capital gains and expense \ cost base side) in such situations[19].

It is not clear from the paper whether the ATO or Treasury has researched the image rights contracts typically entered with an associated entity (a company or trust associated with the sportsperson, performer etc) to gauge the operational feasibility of the policy proposed in the paper.

For example, Ms Aussie Starlet's company may enter into a contract with Hollywood Productions Inc which bundles together a range of services which Ms Starlet must provide as part of her lead role in a movie. Consideration for use of Ms Starlet's image will not necessarily be separately identified or valued in the contract.

Behavioural responses

Even if image rights income is separately identified in Ms Starlet's contract, one could confidently expect that, in response to the new policy, one of the likely future behavioural responses to the proposed tax policy would be to bundle Ms Starlet's obligations and monetary entitlements, thus exacerbating the practical apportionment problem.

This was one of the reasons why the ATO's 10% rule of thumb proposal in PCG 2017/D11 was so attractive.

Deductibility

If Australia is to extend the income tax net to image rights arrangements, what are the corresponding ramifications for deductibility?

A person's image is often cultivated: developed, maintained and enhanced by expenditure[20] on:

- Personal self-development services
- Coaching in areas unrelated to the core skillset (e.g. public speaking and media skills)
- Legal expenses
- Management expenses
- Speakers' bureau fees

[18] [2015] EWCA Civ 3
[19] Refer Division 86 ITAA 1997 calculations relevant to a personal services entity for example.
[20] Expenditure may by capital or revenue in nature for income tax purposes, depending on the circumstances and may not coincide with the period in which income is earned.

- Advertising and product placement
- Website and related social media content
- Travel
- Attendance at functions which often involve entertainment[21]
- Clothing and personal grooming[22]

GST registration and input tax credit entitlements also arise.

Image rights entities

It is unclear whether the treatment of image rights companies will be modelled on the personal services entity rules in Division 86 ITAA 1997.

For example, we imagine the proposed legislation will acknowledge distributions by way of salary from an image rights entity as a reduction against the attributed tax liability of the associated individual[23].

But what of distributions by way of dividends or allocations of trust net income (especially given the aforementioned apportionment issues)?

And what deductions will be allowed in respect of the image rights company[24] and to the company itself?

What happens where the image rights activities result in a loss?

Jurisdictional aspects

The paper states that there is no intention to make "any changes to the source income rules governing the allocation of primary taxing rights"[25].

We are nonetheless concerned about the jurisdictional aspects of the proposal.

In our view, this proposed impost will mainly impact Australian tax residents.

Australia finds it difficult to assert source of image rights income where a non-resident works in Australia for short periods[26].

Take for example a famous offshore tennis player who visits Australia each year to play in the Australian Open, and whilst here, appears in a media campaign generating substantial income from the use of his or her image promoting Australian goods and services pursuant to a product endorsement contract signed offshore, where the advertisements were also filmed, and payment occurred[27].

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[21] Note the "entertainment industry" exception which applies to the general rule that entertainment expenditure is not deductible: s32-40 ITAA 1997.
[22] Some of these costs would be deductible already under s8-1 ITAA 1997. See for example the ATO's occupation-based guidance dealing with work-related expenses incurred by performing artists and professional footballers.
[23] Similar to the operation of s86-15(4) ITAA 1997 in the personal services income rules.
[24] Division 86 also allows limited "entity maintenance deductions".
[25] Refer page 11 of the paper.
[26] Double Tax Agreements are relevant, but generally restrict Australia's income tax rights to situations where a person's personal activities are exercised here.
[27] The source of remuneration for services rendered depends on the facts of each case. Although the source is generally the place where those services are performed (*FCT v French* (1957) 98 CLR 398), other factors may apply in cases where special skills or creative talents are being rendered (*FCT v Mitchum* (1965) 113 CLR 401). In the

As implied in the paper[28], there is potential for horizontal inequity here.

An AFL player (who must ply his or her trade in Australia) may experience substantially different tax outcomes on image rights arrangements compared to the foreign tennis player in the previous example.

Changing tax residency

Some Australians (especially those not part of a team-based operation) impacted by the proposal are highly mobile and can easily, justifiably locate themselves outside the scope of Australia's system of taxing resident individuals on their worldwide income.

It is unclear whether Treasury has factored this particular behavioural response into its thinking.

Post career earnings and business development

There are numerous examples of taxpayers whose image and fame continues to generate substantial income long after the career which generated their notoriety has ceased. In some cases, the income so generated extends far beyond the exploitation of an individual's image.

An oft-cited example in the UK is David Beckham, whose post-football career dividend from his company, DB Ventures Limited, in 2017 was reportedly $32.5 million[29].

At some stage during its history, one could surmise that DB Ventures Limited grew from perhaps being a company with rights to Mr Beckham's image into a substantial, multi-faceted business generating substantial tax revenue (the company reportedly now has several major clothing and other product brands).

We use Mr Beckham's commercial success as an analogy to highlight the issue of:

- Whether there should be a temporal nexus test in the proposed law between the *current* performance of individual services (e.g. as a footballer) and the generation of income by the associated entity.
- Business growth – at what stage of the business continuum does it become inappropriate to treat an entity simply as an "image rights company"?
- Apportionment of business income between income from image rights and other "active" business income" of the associated entity (see above).
- Whether the proposed legislation should include a facility for the Commissioner to determine that a particular entity's activities are such that it is immune from attribution under the image rights measures. There is a precedent for this in the personal services income rules[30]. For some, the power to make such a determination would alleviate the lack of any proposed transitional measures[31].

latter decision, factors such as the place of negotiation and execution of the contract were considered relatively more important.

[28] Refer page 7 of the paper in describing how the ATO's efforts originally focused on persons performing in teams.

[29] Richard Moriarty, *David Beckham earns a phenomenal sum years after retirement from football*, news.com.au, 2 January 2018.

[30] Refer s87-60 ITAA 1997 which enables the Commissioner to make a personal services business determination.

[31] Refer page 12 of the paper.

Post mortem issues

It is conceivable that image rights income may be generated by the estate of a deceased person whose lifetime talents generated an image or fame of lasting commercial value[32]. We have not had time to research this issue or consult with legal specialists.

We simply note that this issue is not canvassed in the paper and assume that no attribution to the estate would occur in such cases. This should be clarified in the drafting and Explanatory Memorandum.

Image rights of children

It is also conceivable that minors will be impacted by the proposal. Parent-controlled entities are sometimes established to manage the affairs of talented children.

The paper is silent on whether Division 6AA ITAA 1936 penal rates of taxation would apply to attributed income.

We would have thought that image rights income would be treated as equivalent to employment or business income, treated therefore as excepted net income and taxed at adult rates[33]. It would be good to clarify this in the Explanatory Memorandum.

Workshops

CAANZ is a strong supporter of pilot programs to "debug" new tax initiatives.

Apart from the consultation process now underway, we strongly urge Treasury and ATO officials to engage in face to face meetings with relevant industry bodies to work-shop the proposals using actual contractual arrangements as case studies. There are also experienced professionals in the accounting and legal sector which specialise in sports law, performing arts etc who should be invited to these workshops.

Defer the start date

CAANZ doubts the 1 July 2019 start-date is feasible given the short amount of time available for consultation and drafting. We strongly suggest 1 July 2020.

As noted in the paper, there are no transitional measures proposed so taxpayers impacted by the proposal and their advisers need sufficient time to unwind or rejig existing arrangements if necessary. They need to see draft legislation to start deliberations on what to do.

We also gather the Federal Government and Treasury have other pressing priorities (including a brought-forward Federal Budget deadline) and there is the curtailed parliamentary sitting period for the first half of calendar year 2019 due to a likely Federal Election by mid-May 2019.

Intellectual property and privacy reform

The paper makes clear that this is a taxation measure and "…would not extend to income from the use or exploitation of property rights currently recognised by intellectual property laws (such as patents or copyrights)". The paper goes on to say that "[T]his measure concerns the tax treatment of fame or image income and is not intended to extend to income attributable to intellectual property rights recognised under Australian law".

Fair enough.

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[32] Bradman family sues in Don's name, The Age, 2 August 2008.
[33] Work out if you receive excepted income, ATO website.

But the strange outcome in the paper is recognition of image rights in a tax law context, but not for any other purpose in Australian law.

This raises an obvious question which the Attorney-General and his State and Territory counterparts may be called upon to answer in policy debates: why not *also* reform relevant intellectual property and privacy laws?

In the United States of America for example, our understanding is that so-called "right of publicity" laws in most States prohibit the unauthorized use of a person's name, image, or other aspect of identity for commercial purposes[34].

"Passing off" remedies available in Australia[35] would appear to be inadequate, outdated and costly.

If you wish to discuss this submission, please contact me by phone (+61 9290 5609) or via email at michael.croker@charteredaccountantsanz.com

Yours sincerely

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[34] Mark S. VanderBroek, Understanding False Endorsement and Right of Publicity Claims in a Digital Age, INTA Bulletin, 15 July 2018.
[35] Refer page 4 of the paper.

Appendix A

Chartered Accountants Australia and New Zealand

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