

## THOMSON ATP WEEKLY TAX BULLETIN

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### Not Just a Game – footballers and management fees - by Gary Fitton, Director, Remuneration Strategies Group

In what must be a first for the Federal Court, and for the competing and rival football codes of Australian Rules and Rugby League, Gordon J has ruled in 2 separate cases that the payment of management fees by professional, full-time football players to their respective managing agents were tax deductible under s 8-1 of the ITAA 1997. See also report at 2007 WTB 50 [2222]. The cases were:

- *Riddell v FCT* [2007] FCA 1816 ( *Riddell's case*); and
- *Spriggs v FCT* [2007] FCA 1817 ( *Spriggs' case*).

In both cases (ignoring for the moment the respective rules of the games), the factual matrix and Gordon J's application, analysis and interpretation of the relevant taxation provisions are very similar. Consequently, both cases are considered in this article and case paragraph references are given as numbers and letters, ie R for *Riddell* and S for *Spriggs*.

Interestingly, both games have historic developmental links to Australia. Australian Rules to Melbourne, Adelaide and Perth and Rugby League to Sydney (and Yorkshire).

#### **Background**

While both Riddell and Spriggs were employees of their respective football clubs, the governing NRL and AFL playing rules expressly acknowledged that each player could receive income from a Club and other income (eg marketing, promotional activities and rights) from a variety of other sources (at paras 8R, 9R and 20S, 24S).

Both Riddell and Spriggs were signatories to exclusive player management agreements. The role of their agents was to represent, promote, manage and assist in negotiations with their respective clubs and the other income-producing activities.

In both cases, the managing agents were remunerated on a percentage of their players' club player contract payments and income from other sources (eg marketing and media activities).

The promotional activity for both Riddell and Spriggs involved major television network appearances, appearance at major events, card royalties, appearances in calendars, sports clothing and equipment sponsorships, that have become typical of the income-producing activities of professional sportspersons.

### **The central issues**

In both cases, Gordon J outlined the central issues as being whether the management fees were tax deductible under s 8-1. In particular (at paras 12R and 8S), were the respective management fees paid by Riddell and Spriggs:

- incurred in gaining or producing their assessable income in the 2005 income year under s 8-1(a)?
- incurred in carrying on businesses for the purposes of gaining or producing their assessable income in the 2005 income year under s 8-1(b)?
- an outgoing incurred at a point too soon to be incidental and relevant to their respective income producing activities?
- a loss or outgoing of capital or of a capital nature under s 8-2(a)?

### ***Management fees***

Both Riddell and Spriggs incurred outgoings for the year ended 30 June 2005 to their respective managing agents.

In the case of Riddell (at para 34R), the invoice issued by the managing agent, International Sports Management Pty Ltd, dated 17 November 2004, was for "2005 management fees \$19,250".

In the case of Spriggs (at paras 21S), the invoice issued by the managing agent, Connors Sports Management Pty Ltd, dated 20 December 2004, was for 'Management and Promotional services by CSM for season 2004 \$2,100, GST \$210, total \$2,310'.

It was those fees which the Commissioner of Taxation contended were not tax deductible in the 2005 income year.

### **Stone's case**

In both cases, Gordon J drew directly from the majority joint decision of Gleeson CJ, Gummow, Hayne and Heydon JJ of the Full High Court in *Stone's case* (2005) 59 ATR 50. In that joint majority decision, the judges identified the phenomenon of professional sport as a development of the second half of the 20th Century.

*Stone's case* is both appropriate and interesting. It concerns issues as to whether *all* the payments to the taxpayer as a professional sportsperson constituted assessable income. The taxpayer in this case was Joanne Stone, a Queensland policewoman and a highly successful Australian Olympic javelin thrower. Her payments from sport included (at 43):

- Prize money totalling \$93,429;
- Government grants of \$27,900;
- Sponsorship of \$12,419; and
- Appearance fees of \$2,700.

While the taxpayer conceded that the sponsorship moneys she received were assessable, the Full Federal Court held that the amounts received as appearance moneys were assessable, but neither prize moneys nor grants constituted assessable income (at para 5).

The Commissioner appealed to the Full High Court on the basis that he would pay the taxpayer's costs of the proceedings. The High Court found that all the payment items received by the taxpayer constituted assessable income as they were produced from her income-producing activities that included the carrying on of a business (at para 63).

### ***Stone and deductibility of business expenses***

Importantly, the majority joint decision of the High Court in the *Stone* case flagged that there were (at para 64),

"...consequences for deductibility of business expenses that follow from a conclusion that the taxpayer was conducting a business."

It is those 'consequences' for deductibility of business expenses that preoccupied Gordon J in the *Riddell* and *Spriggs* cases.

### **Relevant legislation**

The relevant legislative analysis in the *Riddell* and *Spriggs* cases concerns the provisions of s 8-1 of the ITAA 1997, which provides that:

"(1) You can deduct from your assessable income any loss or outgoing to the extent that:

(a) it is incurred in gaining or producing your assessable income; or

(b) it is necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.

(2) However, you cannot deduct a loss or outgoing under this section to the extent that:

(a) it is a loss or outgoing of capital, or of a capital nature; or

(b) it is a loss or outgoing of a private or domestic nature."

The term 'business' is defined in s 995-1 of the ITAA 1997 as including 'any profession, trade, employment, vocation or calling, but does not include occupation as an employee'. Gordon J

then applied those provisions to the actual circumstances of both cases, analysing whether those provisions had application to the activities of Riddell and Spriggs.

### **The first positive limb: s 8-1 (a)**

In both cases, Gordon J ruled that to meet the provisions of the first limb, "...expenditure must be incidental and relevant to the gaining and producing of assessable income" (at paras 36P and 38S).

She noted that,

'What is incidental and relevant is determined not by reference to the certainty or likelihood of the expenditure resulting in the generation of income, [but]...whether it is in truth an outgoing incurred in producing assessable income.' (at para 38S).

Gordon J also noted that,

'The phrase 'assessable income' refers not to the assessable income of the year in which the expenditure was incurred but to assessable income generally:' (at para 39S).

She finally noted that (at para 40S) '...even if an item of expenditure cannot be traced to a particular item of income that fact of itself does not mean that the expenditure is not deductible'.

### **Timing issues**

Gordon J cautioned (at paras 40S and 53R) that,

'However, an item of expenditure may not be deductible if it was incurred at a point too soon before the income producing activity commenced or if it was incurred after the income-producing activity has ceased:'.

This timing issue in relation to expenditure and the income-producing expenditure emanates from the decision of the Full High Court in *FCT v Maddalena* (1971) 45 ALJR 426.

### ***Maddalena's case***

*Maddalena's* case concerned a taxpayer who derived income as an electrician and as a professional rugby league footballer playing in the then NSW Rugby Football League of the early 1970s. In the majority decision delivered by Menzies J, it was ruled that, as both a player and an electrician, Maddalena was *not* carrying on business and that he was operating solely as an employee.

Consequently, as an employee and not carrying on a business, the Full High Court ruled that moneys expended on seeking work as an employee (ie under the first limb of s 51(1) of the ITAA 1936), would *not* be deductible.

However, if Maddalena were to be a principal of a business and carrying on a business, the High Court ruled that moneys expended to obtain contracts would be deductible under the second limb of s 51(1).

**Issue 1: were the management fees incurred in producing their assessable income in the 2005 year under s 8-1(a)?**

Significantly, in *Riddell* and *Spriggs*, in regard to the timing issue concerning the expenditure, both sets of management fees were incurred some months after the club playing contracts had been entered into (at paras 38R and 45S).

Gordon J also found that (at paras 41R and 47S):

'...employment does not preclude expenditure from being deductible under the first positive limb. [Indeed] it is common for expenditure relevant and incidental to income earned under employment to be deductible.'

She also noted (at paras 41R and 47S) that, in the particular circumstances of these 2 cases, the playing contracts expressly contemplate the 'exploitation' of Riddell and Spriggs as NRL and AFL professional footballers (at paras 41R and 47S).

**Issue 2: were the management fees incurred in carrying on a business for the purpose of gaining or producing assessable income in the 2005 year under s 8-1(b)?**

In both cases, the Commissioner did not contend that it was not possible for a professional sportsperson to be carrying on a business of exploiting his or her sporting talent (at paras 42R and 48S). In both cases, Gordon J quoted the majority High Court decision in *Stone's* case with approval, where it was ruled that,

'The conclusion that the taxpayer was engaged in a business during the 1998-1999 year proceeds from an acceptance of the proposition that, showing that both before and during that year, the taxpayer was paid to endorse a company or its products as an athlete demonstrated that she has turned her athletic talent to account for money.'

Gordon J found that both the *Riddell* and *Spriggs* cases were not distinguishable from the situation in *Stone's* case and, consequently, that the management fees were incurred by Spriggs and Riddell were incurred in the carrying on of a business (at paras 43R and 48S).

Gordon J also rejected the Commissioner's contention that a business needed to demonstrate some sufficiency of marketability and sustenance of viability, ruling (at para 51R) that 'a business does not have to be successful to be a business.'

**Issue 3: were the management fees incurred at a point too soon to be incidental and relevant to the income-producing activities?**

The phrase 'come at a point too soon to be properly regarded as incurred in gaining assessable income' was first used by Menzies J who delivered the majority High Court decision in the *Maddalena* case.

The Commissioner relied on *Maddalena's* case in contending that the management fees were not deductible because they were incurred '...at a point too soon to be properly incurred in gaining assessable income'. However, Gordon J ruled that the Commissioner's reliance on *Maddalena* was misplaced (at paras 52R and 56S).

Gordon J rejected the Commissioner's arguments that the fees were incurred '... at a point too soon...' and found that the management fees incurred by Riddell and Spriggs were both incurred after the playing contracts were signed and could not be charged if the playing contracts were not negotiated (at paras 53R and 63S).

Her Honour ruled that 'the factual matrix in *Maddalena* is very different to the factual matrix of *Riddell* [and *Spriggs*].' (at paras 52R and 61S).

She ruled further (at para 52R) that:

' *Maddalena* concerned an era of professional sportsmen and sportswomen which bears little or no resemblance to professional sport in the twenty first century. One only has to point to the absence of the electronic media or let alone the internet, ...to make good that proposition.'

And concluded that 'Riddell [and Spriggs] was a professional footballer. *Maddalena* was not.' (at paras 53R and 63S).

#### **Issue 4: was the management fee a loss or outgoing of capital or of a capital nature?**

The Commissioner submitted that even if the management fees were incurred by Riddell and Spriggs in gaining or producing assessable income, if they were on capital, not revenue, account and therefore not deductible under s 8-1 (at 54R and 64S).

Gordon J went on to restate the 'classic test' (at paras 55R and 65S) for resolving the distinction between capital and revenue as enunciated by Dixon J in *Sun Newspapers Ltd and Associated Newspapers Ltd v FCT* (1938) 61 CLR 337 (at 363) as being consideration of:

- (a) the character of advantage sought and in this its lasting qualities;
- (b) the manner in which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part; and
- (c) the means adopted to obtain it, that is by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.

The Commissioner contended (at paras 57R and 67S) that the management fees were capital on the bases that:

- the advantages that the management fees secured were 'structural advantages';

- the management fees were not part of the process by which Riddell and Spriggs derived their salary income; and
- they were one-off payments required to secure the contracts that would provide them with their principal sources of income.

However, in both cases, Gordon J rejected those contentions (at paras 57R and 67S). She ruled that the management fees were paid for particular services concerned with exploiting the talents of professional NRL and AFL footballers.

Gordon J concluded that none of the factual circumstances suggested that the management fees were affairs of capital and they secured no lasting assets (at paras 59R and 69S).

### **Conclusion**

Clearly, the *Riddell* and *Spriggs* cases are correct and definitive declarations by the Federal Court and High Court of the taxation law in respect of determining the taxable income of professional sportspersons in the 21st Century.

The Australian courts are to be congratulated on recognising the need to maintain a full professional approach by employees and others also involved in carrying on businesses and the need to broaden the bases for deductibility of expenses incurred in maintaining that professionalism, to maximise their income-producing potential and to enhance economic productivity levels.

The decisions are also indicative of a broader development of a significantly greater degree of professionalism and performance levels of labour services generally ie beyond the boundaries of professional sport.

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