

GSLTR

Global Sports Law & Taxation Reports

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Esports and taxation

BY SEBASTIAAN VAN OVERBEEK¹ AND DICK MOLENAAR²

Introduction

Esports is competitive computer gaming in tournaments with professional gamers, mostly using the internet (online), but sometimes at special organized events (offline).

Esports is becoming a major industry, as the top gamers around the world battle each other, which is creating a huge spectator sport and is, therefore, attracting bigger sponsors. Also the developers of the games have an interest in tournaments with considerable prize money, because this increases the status of their games and the sale to amateur users.

Esports is the collective term for a wide range of games. The games can be played on various websites and can be seen on Twitch.com, YouTube.com and other websites. There are hardly borders for esports, the games are most popular in the USA and Asia, but also in Europe and other places.

Betting games, such as poker, are not considered as esports because in these games not the capacities of the players but the luck of the draw is most influential on the result of the game.

This article will discuss which esports games exist; how they are played; which types of income are relevant for the various games; and what the tax consequences may be.

Esports is a basket with different types of games

Top games

The most successful esports games in order of prize money until now are³:

- 1 Dota 2,
- 2 Counterstrike: Global Offensive,
- 3 League of Legends,
- 4 Starcraft IIv
- 5 Fortnite.

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³ Source: www.esportsearnings.com (accessed 30 November 2018).

This list should not be regarded as static, considering that games become outdated with the release of newer ones. For example, in 2018, *Dota 2* has lost its top position to *League of Legends* (1), *Playerunknown's Battlegrounds* (2) and *Hearthstone* (3), with *Overwatch* (5) just a little behind and *Fortnite* rising fast (11).⁴

Multiplayer online battle arena

Very popular are the multiplayer online battle arena games (MOBA), such as *Dota 2* and *League of Legends*.

In these games, normally two teams of four to five players play against each other and both the players and the viewers view the game from above. Each player has his own character in the game and the main goal is to destroy the base camp of the opponent. It is important for a team to choose the right combination of characters to best play out the game.

MOBA-game players train between tournaments alone or with the team to improve their performances. Professional teams very often have coaches who study the opponents, come up with a strategy and select the players for the team.

First-person shooter

Also very popular are the first-person shooter games (FPS), such as *Counterstrike: Global Offensive (CS:GO)* and *Overwatch*. In these games, the teams fight with each other from a first-person perspective.

CS:GO is a standard FPS, with two teams of five players, playing half of the rounds in defence and the other half in attack. Teams win through their ability to aim, knowing the map and the execution of their strategy to set off/disable a bomb that will finish the game.

Overwatch, although also an FPS focusses more on picking the right combination of characters which each own different abilities and play a certain role in the game. Each play round consists of four maps with different goals.

Battle royal games

Relatively new and upcoming are battle royal games (BR), such as *Fortnite*, *Playerunknown's Battlegrounds* (PUGB) and (in part) *Call of Duty*. The games are played either individual or in teams of two to four players with the goal to eliminate the opponents. PUGB teams already have coaches although with *Fortnite* this is not yet that common.

⁴ Newzoo, 2018 *Global Esports Market Report*.

Real-time strategy games

Notwithstanding *Starcraft II*, real-time strategy games (RTS) seem to have fallen mostly out of favour within esports. Original RTS games are often played between individuals and therefore players are not managed by coaches.

Turn-based games

Less common in esports are turn-based games (TR), such as *Hearthstone*. These games look like e.g. chess, because per turn only one action can be taken. *Hearthstone* works with a deck of cards and the player makes his moves on the cards which are drawn. Partly, players have no control over the outcome of the match due to the luck of the draw. Goal in *Hearthstone* is to bring down the points of the opponent to zero.

Sports-based games

A different type of games are sports-based games (SP), such as *FIFA 19*, which is based on football. *FIFA 19* and the equivalents for other sports allow players to play the sport in a virtual environment, either in teams or on their own. Now, in The Netherlands, football teams have their own e-players who represent the club in a national e-division, which is structured similar to the national football league. With *FIFA 19* the clubs try to attract more young people to the game of football and hopefully also to the stadiums for the normal football matches.

UEFA has announced to start with an eChampions League and to add an esports tournament to EURO 2020. This means that *FIFA 19* will attract more attention in the coming years.

Online and offline

Competitive gaming is not a new phenomenon, since the days of *Pacman* people compete with each other in achieving the highest score. With the existence of internet and its widespread availability it comes as no surprise that gaming grew to a competitive environment. As a result, players and companies organise tournaments in which competitors earn prize money. As the tournament scene grew larger esports was born.

Right now, the most attractive form of esports is played on location (offline). Players travel to a studio or stadium where computers have been setup for them to play on. Fans can visit these events and watch the game on a big screen. At the same time these games are streamed to websites like *YouTube* and *Twitch*.

A recent event with worldwide viewership was the 2018 League of Legends World Championships held in Korea (Seoul, Busan, Gwangju and Incheon) from 1 October until 3 November. The final was held in the Incheon Munhak Stadium with Invictus Gaming from Korea as the final winner. Other recent examples were Blizzcon 2018 for *Hearthstone* on 2 and 3 November in Anaheim, California, and The International for *Dota 2* from 20 until 25 August in Vancouver, BC, Canada.

Gamers are also able to participate in online tournaments which can be joined from all over the world from their own

computer. Because online tournaments are more accessible it allows a wider range of competition. Online tournaments most often have lower rewards than offline tournaments and very few of them receive a decent amount of viewership, however this does not hold true for every game.

Sources of income

A major source of income for esports is advertisement for esports related products as well as for other services and products. Manufacturers of computer equipment or software have an interest in advertising, such as Sony PlayStation, Microsoft Xbox, Asus computers and others, but also brands for the normal world are active with advertising, such as MasterCard, T-Mobile and other big companies.

Furthermore, prize money is important, initially funded by the developer of the game because of his interest in promoting the game and attracting more (amateur) users and viewers, but later increased with the income from advertisement, sponsoring and the income from ticket sales and consumption at the offline events.

Other income can be obtained from the (amateur) players by in-game sales, such as new characters or extra options during the game. For the exporters themselves income is for a large part derived from their own streaming channel which gives viewers the option the subscribe and donate cash. Since 2014 alone *Twitch* processed US\$ 257 million in donations by viewers.⁵

Newzoo has calculated that the total esports market will be US\$ 906 million in 2018⁶, which is 38% more than in 2017. North America will count for US\$ 345 million, China for US\$ 164 million and Europe for US\$ 250 million. Brands invest US\$ 694 million in the market with sponsoring, advertisement and such, which is 77% of the total market.

In 2017, there were 588 major esports events that generated US\$ 59 million, up from US\$ 32 million in 2016. The total prize money of all esports events held in 2017 reached US\$ 112 million. The League of Legends World Championship was the most watched event on *Twitch* in 2017 with 50 million hours. It also generated US\$ 5.5 million in ticket revenues. The expectation is that the total esports market will grow in 2021 to US\$ 1,650 million.

The 2018 revenue streams can be divided into:

– media rights	US\$ 161 million	18%
– advertising	US\$ 174 million	19%
– sponsorship	US\$ 359 million	40%
– merchandise + tickets	US\$ 96 million	11%
– game publisher fees	US\$ 116 million	12%

⁵ Source: www.bbc.com/capital/story/20180924-the-rise-of-the-twitchpreneurs-and-the-evolution-of-tipping (accessed 30 November 2018).

⁶ Newzoo, 2018 *Global Esports Market Report*.

Is esports a sport?

Some discussion is going on about the question whether esports can be seen as sports.⁷

The main critics mention the lack of transparency, because most of the games are controlled by the game publishers. They can set and change the rules if they want, select the teams and do not allow normal sport governance and procedures, such as appeals against decisions and doping checks. Critics believe that esports are just entertainment because of these missing key elements to qualify as a sport.

Undoubtedly, there are entertainment elements in esports, as in most of the normal sports, but esports look more as sports because of the competition element, scoring and tournament structures. For the players and viewers esports will be considered as sports.

For tax purposes, the scope of the term sports has been discussed by the OECD in its Model Tax Convention for direct taxation⁸, and by the European Court of Justice (ECJ) in its decision about duplicate bridge⁹. The conclusion from these two totally different sources lead to the conclusion that esports for taxation can be considered as a sport.

Betting tax

The first tax consideration to be made is whether a game can be seen as betting because the luck element in the game is dominant, or whether it is a skills-based game because of the influence of the player. About poker many discussions have taken place, also in tax courts, and even though some experts have argued that the personal skills element is more important than the luck element, the decisions from the tax courts are that the luck element brings poker under the betting tax.¹⁰

This brings the tax administrations in many countries to the idea that also other online games would be betting, but, in our opinion, this conclusion is too simple and not based on good insight into the various esports games.

Only *Hearthstone* is played with cards and, therefore, includes the luck of the draw, but success in the other big games such as *Dota 2*, *League of Legends* and *Fortnite*, depends on the capacities, skills, training and talent of the players. Inevitably, some luck will influence the outcome, but this not more than in normal sports. Therefore, in our opinion, betting tax is not the correct way of taxing

the income from the esports discussed in this article.

Betting tax has the disadvantage that it is most often a fixed tax rate of 20% to 30%, applied to the gross income, without the deduction for expenses allowed. The underlying idea from countries is that a betting tax should be simple to be levied in practice. The example of poker already shows that this can be very different in cross-border situations, such as with online poker, but also with offline events, because the taxing right may then be with two or more different countries. And the expenses can be different, because a poker player can have several investors supporting him or her for the stakes in the tournaments and, therefore, also receiving shares of the results. This sharing can go up to 50% or more and when these expenses are not deductible for the betting tax, the effective tax rate of the profit can rise to more than 100%, which means that the betting tax takes away more than the profit.

However, many countries have solved this problem with a connection between betting tax and normal income or corporation tax. When a poker player has a personal or limited company, the profit from the activities will fall under income or corporation tax and the betting tax can be deducted as a withholding tax from the final tax obligation. This can even lead to a tax refund, but only when the income comes from the same country. But the credit for foreign betting tax shall be restricted to an equal part of the income or corporation tax, the same as with the ordinary tax credit in tax treaty situations. This can easily lead to excessive taxation with a partly non-creditable foreign tax.

Within the EU this shall be seen as an obstruction for entering other EU markets and, therefore, an obstruction of the freedom principles. The European Court of Justice (ECJ) has decided in cases about gross taxation of non-resident artists that the non-deductibility of expenses cannot be allowed and that the use of normal tax rates should be provided for non-residents.¹¹ But it remains up to the source countries to apply the source taxation to the non-residents.¹²

Employees or self-employed

For the payments from teams or tournament organizers to esports players, the legal status of the relationship is important. Are the players employees because they must follow the instructions of the team or can they be seen as self-employed because they act during preparations and games as skilled experts in their own way? Besides for taxation, this difference also has its consequences for labour law, social security, work permits and other legal areas.

We can imagine that especially teams in which players need to play together and use coaches to select the players, observe the opponents and come up with a team strategy, the chance is very likely that the players are considered employees. This means that the team

⁷ E.g. at the EU Sport Forum on Malta in March 2017, report can be found at <https://ec.europa.eu/sport/sites/sport/files/docs/docs/eusf-esports.pdf> (accessed 30 November 2018). Also in J. Holden, A. Kaburakis, R. Rodenberg, "The Future is Now: Esports Policy Considerations and Potential Litigation", in: *Journal of Legal Aspects of Sport*, 2017/27, p. 46-78.

⁸ See further on in this article the paragraph "Income taxation and tax treaties".

⁹ See further on in this article the paragraph "VAT".

¹⁰ Such as in The Netherlands: Hoge Raad, 11 July 2014, ECLI:NL:HR:2014:1624.

¹¹ See ECJ 12 June 2003, C-234/01 (Gerritse) and ECJ 3 October 2006, C-290/04 (Scorpio).

¹² See ECJ 18 October 2012, C-498/10 (X NV (Football Club Feyenoord)).

has to withhold wage tax and pay social security contributions and very often the deduction of expenses has been restricted, as is normal for employees.

Individual gamers outside teams will be seen as self-employed, which means that they have to pay income tax and arrange insurances themselves. This may also be the case for players in not strict organized teams. Some countries allow self-employed special tax advantages, which can make it profitable for teams and players to assume self-employed status over employment. This also takes away the employer's responsibilities from the team. But the tax administrations in those countries are aware of this behaviour and will audit whether the correct employment status is applied by teams.

Income taxation and tax treaties

Esports are played on an international stage, which means that the chance of double income taxation is likely. Most countries have a source withholding tax on income earned by non-residents, while almost every country taxes its residents on their worldwide income. This creates an overlap, because foreign income is taxed twice with these two systems. The result from this can be that less foreign activities will be undertaken, which is bad for the economy. Countries are, therefore, concluding bilateral tax treaties with each other, allocating taxing rights and granting tax exemptions or credits, so that double taxation should be prevented. The OECD in Paris has brought this together in 1963 in its Model Income Tax Convention, which is followed not only by the 30 member states, but also by many other countries.

Esports will fall under all four basic articles from the OECD Model. Sponsorship will be taxed in accordance with art. 7 (Business profits); media rights with art. 12 (Royalties); prize money with art. 17 (Entertainers and sportspersons); and employees from teams, either players or supporting staff, with art. 15 (Income from employment).

Especially the exceptional rule of art. 17 for entertainers and sportspersons creates many problems in practice. This article is an anti-avoidance measure, because top stars are very often so mobile that they can presume to live in another country than normal. And with tax havens such as Monaco not having any income tax, it may be profitable to move the residency to this principality. In normal sports, cyclists, tennis players, golf players and Formula 1 drivers (such as Max Verstappen) have taken this step. Without a source tax in the countries of the tournaments there would be no income taxation for these self-employed persons.

In contrast, the 95% medium and smaller-sized entertainers and sportspersons suffer from the harsh measures against this tax avoidance, because very often source tax is levied from gross prize money and appearance fees and expenses are not deductible, while information about the taxation in the various countries visited during a sports year is very often missing. This means that the taxable base in the residence state is most often much lower than in the work state and the foreign tax cannot be credited completely

in the residence state. This leads to the result that art. 17 OECD Model creates excessive or even double taxation.

Unfortunately, this will also be the case for esports, because the OECD has included a broad view on sports in the Commentary on art. 17. It does not give a precise definition but makes clear that it does not restrict sports to traditional athletic events and mentions other sports as examples, including golf, cricket, tennis, billiards, snooker, chess and bridge.¹³ Esports will definitely meet the conditions for art. 17 OECD Model.

For offline tournaments, it is easy to determine in which country the esports match or tournament takes place, but this is different for online tournaments. Then the computer server is very often in another country than the players and the organizing company paying the prize money can even be based somewhere else. It is, therefore, hard for countries to raise a legitimate source withholding tax on online esports tournaments.

VAT

Is esports a sport for VAT?

The question whether esports is a sport comes back for EU VAT purposes in the decision of the European Court of Justice (ECJ) about duplicate bridge.¹⁴

Duplicate bridge is a form of bridge in which each partnership successively plays the same deal as their counterparts at other tables. Scoring is thus based on relative performance. The ECJ came to the conclusion that duplicate bridge cannot be considered a sport, because it is characterised by a physical element that appears to be negligible. Therefore, the VAT exemption does not apply.¹⁵

The English Bridge Union had brought forward that duplicate bridge involves logic, memory and planning, which constitutes an activity beneficial to the mental and physical health of regular participants, but the ECJ found this "contribution" not sufficient for the conclusion that this was a "sport" for VAT purposes, because it had to be a physical or mental activity itself.

The ECJ gave the English Bridge Union some help by explaining that duplicate bridge could fall under "cultural services", for which also a VAT exemption exists.¹⁶

It seems to be highly likely that the facts of this "Bridge" case of the ECJ are too distant from esports to have an effect. First, the sports exemption only applies to non-profit making organisations, which is not the case in esports. And second, esports require much physical and mental

¹³ Paragraphs 5 and 6 of the Commentary on Art. 17 OECD Model.

¹⁴ ECJ 26 October 2017, C-90/16 (The English Bridge Union).

¹⁵ Art. 132(1)(m) of VAT Directive 2006/112/EC.

¹⁶ Art. 132(1)(n) of VAT Directive 2006/112/EC.

activity, which can be comparable to normal athletes.

For example, a five-year study by Professor Ingo Froböse of the German Sports University in Cologne shows that esports players achieve up to 400 movements on the keyboard and the mouse per minute, four times as much as an average person, while the activity is asymmetrical because both hands are being moved and various parts of the brain are being used at the same time.

Most games are extremely complex, because in addition to the motor skills, the games require a high degree of tactical understanding to defeat an opponent. The research also showed that the production of the stress hormone cortisol is at the same level as that of a racing-car driver, combined with a high pulse, sometimes up to 160 to 180 beats per minute, which is equivalent to what happens during a very fast run, almost a marathon.

An esports career, therefore, most often ends in the mid-20s age when reflexes start to go and younger competitors are at an advantage; only with physical and mental training and nutrition, a career can be extended.¹⁷

Therefore, esports should be considered as sports for VAT purposes, which means that the entrance fee for both players and audience for online and offline events can be taxed at the low VAT rate, if the EU member state has taken over this option from the EU VAT Directive.¹⁸

No EU VAT on prize money

Normally, esports teams and self-employed players will be taxable persons for VAT purposes. They provide services for which they receive payments and, therefore, they need to charge VAT on the invoices for these payments. Strangely enough, earning prize money through competition does not fall under the scope of VAT, which follows from the Bastova decision of the ECJ¹⁹.

In this case, the horse breeding company Bastova from the Czech Republic had various activities for which it has charged VAT, including prize money from horse races. The ECJ decided that the participation in the horse race did not constitute a supply of services for art. 2(1)(c) EU VAT Directive 2006/112/EC, because it did not give a fixed remuneration. It depends on the other activities whether this may have consequences for the deductibility of the input tax, but, if so, this ECJ decision disturbs the neutrality principle of the VAT for taxable persons. Appearance fees for teams are still taxable for VAT; only variable prize money is affected by the Bastova decision. Most teams agree with the players that they receive a large percentage of the prize money as

extra compensation for their work, very often up to 80% or 90%, which means that only 10% to 20% of the prize money stays with the team. This means that the potential negative VAT effect on the deductible input tax for the team will be marginal or even nil. And the players are very often not taxable persons, because they are either employees or self-employed, but only working for one client. Therefore, esports could get away without harm with this strange ECJ decision.

Reverse charge system for cross-border services

Esports is very international and payments for services in advertising, sponsoring and media rights can easily come from another country.

Within the EU then the reverse charge system can be applied, if the recipient in the other country has a valid VAT identification number (B2B).²⁰ This means no VAT in the residence state of the service provider (esports team or self-employed player), but a listing needs to be done to comply with the EU administration. When the recipient has his place of business outside the EU, no EU VAT is applicable anyhow, so the invoice falls under the zero rate and no listing is needed. This system does not have any effect on the deductibility of the input tax on the expenses.

But there is an important exception for the entrance fees for esports events, because the EU VAT Directive stipulates that the national VAT applies of the state in which the event takes place.²¹ But, as discussed in the first part of this VAT paragraph, most EU countries have taken over the option from the EU VAT Directive to apply the low VAT rate to the entrance to sports activities.

Conclusions

Esports is a young and fast-growing branch of sports. Gaming already exists for many years, but the internet opportunities paved the way for a thrilling new professional sports category with young players from all over the globe. There may be doubts about the governance and control in the sport, which is run by the game developers and publishers and not by associations as in normal sports. Some say that this hinders the recognition of esports as sports, but, in our view, it is only a matter of time before esports will be taken seriously everywhere.

We have shown that esports is a basket with different games, each having its own characteristics and public following. Esports cannot only be played online but also offline, for which major events are organized that have already reached the regular sports stadiums. Sources of income are coming from sponsorship, media rights, advertising, merchandise, ticket sales and also from the game developers and publishers.

An important issue is whether esports fall under betting

¹⁷ "Science shows that eSports professionals are real athletes", available at www.dw.com/en/science-shows-that-esports-professionals-are-real-athletes/a-19084993 (accessed 30 November 2018).

¹⁸ Annex III, posts 13 (admission to sporting events) and 14 (use of sporting facilities) with the EU VAT Directive 2006/112/EC.

¹⁹ ECJ 10 November 2016, C-432/15 (Pavlina Bastova).

²⁰ Art. 44 of EU VAT Directive 2006/112/EC, after amendment by EU VAT Directive 2008/8/EC.

²¹ Art. 53 of EU VAT Directive 2006/112/EC, after amendment by EU VAT Directive 2008/8/EC.

taxes, as with poker and other games. But our conclusion for esports is that the skills and capacities of the players prevail very much in esports over the luck of the draw.

Also, the division between employees and self-employed is relevant in esports, leading to wage tax and social security contributions. Esports are very international and can easily cross borders, so the special taxing rule of art. 17 OECD Model can apply to esports income. This may lead to excessive or even double taxation because of the rigid rules underlying this exceptional OECD rule.

For EU VAT, we discussed whether esports could meet the criteria set out in the Bridge decision of the ECJ but concluded that these will not apply and the VAT low rate or even the VAT exemption can be used by esports. On the other hand, the strange and disturbing ECJ decision in the Bastova case about variable prize money can have negative consequences for the deductibility of input tax.

Finally, esports have to follow the specific rules for cross-border services with a central role for the reverse charge system.

Altogether, we draw the conclusion that esports is a fascinating new branch in the sports world, not only because of the games but also of the tax implications. With the money streams growing, the tax aspect will, therefore, become more important.