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# Spanish authorities amend the tax treatment of buy-out clauses for football players

In response to a binding consultation made by La Liga, the Spanish tax authorities have eliminated the severe taxation that until now was imposed on the payment of buy-out clauses of professional football players. Enric Ripoll González, a Lawyer at Ruiz-Huerta & Crespo Sports Lawyers, analyses in detail the clarity provided by the Spanish tax authorities on the tax treatment of buy-out clauses.

During the last few years several players have decided to leave Spanish professional football for the chance to play in different leagues (such as the Premier League, Bundesliga, Ligue 1, etc), some of whom were important players so much so that their teams tried to retain them as far as possible, or at least be compensated for their loss. In the event of a player leaving for another league the player's current club would request that the interested club pay the buy-out clause that is established in every contract in Spain. The origin of this clause is established in the Spanish Act 1006/1985 on the Special Labour Relationship of Players, specifically in Article 16, according to which the unilateral termination of a contract by the player, without just cause, will grant the club compensation that in case of no agreement, will be determined by the ordinary labour courts.

Obviously every club in Spain decided to establish such a clause, the so-called 'cláusula de rescisión' or 'buy-out clause,' in order to have some certainty about the amount of compensation to be paid and as a form of protection against other clubs. However, the clause caused

certain problems in regards to taxation, which were explained by my colleague Guillermo Amilibia Pérez, who is currently the in-house lawyer for Real Sociedad SAD, in an article on the matter<sup>1</sup>. In his article, Guillermo described very precisely the problems that the taxation of buy-out clauses were causing for clubs prior to the Spanish tax authorities move to address the issue. Guillermo's article explained the following: a club, intending to acquire the federative rights of a player registered with a team playing in Spain, contacts the current club of the player requesting a negotiation to settle a transfer fee. This scenario leads us to two possible answers from the Spanish club. The first possible answer considers the amount of the existing buy-out clause, the market value of the player and the plans the club may have for the player, and accepts the offer to enter into a negotiation. In the second possible answer, the Spanish club considers the player a key member of the team and rejects the opportunity to negotiate, requesting the payment of the buy-out clause as a transfer fee.

Both scenarios allow the new club to acquire the player, but they are treated differently for tax purposes. In the first

scenario, the agreement between the parties that may establish a value equal to the buy-out clause will be under VAT, which in Spain has been set at 21% since September 2012. This means that an agreement to sell a player in exchange for €100 million would have an extra tax cost of €21 million. In the second scenario, the payment of the buy-out clause is configured in Article 16 of the Spanish Act 1006/1985 as compensation paid by the player to the club for the unilateral termination of the employment contract, and such compensation is deposited to La Liga prior to the termination of the contract. Until now, the amount paid by the player for the purposes of the buy-out clause was considered by the tax authorities as a revenue from the player's work (i.e. personal income tax) that nowadays has a tax rate of 48%, which illustrates that the payment of the buy-out clause is a lot more burdensome than reaching an agreement. Using the same example therefore in the second scenario a buy-out clause of €100 million would have an extra tax cost of €48 million.

In reaction to this, general practice in Spain in the last few years has been

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continued

to reach agreements that are really close, equal or even higher than the amounts established in the buy-out clause. The *Thiago Alcántara* case is the perfect example: Bayern Munich decided to pay €20 million instead of the €18 million established as the buy-out clause in the employment contract with FC Barcelona in order to avoid paying more than €8.5 million as personal income tax by paying €4.2 million as VAT, saving €2.4 million in taxes.

Some commentators considered that the payment of the 48% tax could be avoided using Article 7.e of the General Income Tax Law (Law 35/2006), which establishes that compensation for the dismissal of employees is exempt from taxation (with a limit of €180,000 since 2014). However, this interpretation was strongly criticised because the Law seems to clearly refer to the compensation being paid by the employer to an employee only for the latter's dismissal, not vice versa.

### La Liga's binding consultation

This issue has been solved by the Spanish tax authorities thanks to La Liga, which in order to provide a definitive answer to its members requested that the tax authorities clarify the taxation on the payment of a buy-out clause related to the corporate tax of the buyer club, the VAT and the player's income tax.

### Corporate tax

The tax authorities considered that the Corporate Tax Law (Law 27/2014) and the General Accounting Plan are quite clear regarding the payment of a buy-out clause. On one hand, the Law establishes, in Article 10.3 that: '3. In the direct estimation method, the taxable amount will be calculated by correcting, through the application of the precepts established in this Law, the accounting result determined in accordance with the rules set forth in the Commercial Code, in the other laws related to said determination and in the dispositions that are dictated in development of the aforementioned norms.'

On the other hand, the General Accounting Plan has established since 2000 account 215: 'Player's acquisition rights,' corresponding to intangible assets for sports corporations, which are defined as 'the amount paid for the acquisition of the right to the services of a particular player, that will include the amount to be paid to player's former Club, known as "transfer," and any other expenses needed [for the] player's acquisition.'

The valuation rules that are currently in force establish that those rights will establish:

- The amount to be paid to the player's former club known as the 'transfer,' and
- Any other expenses needed for the player's acquisition.
- In addition, the contract that could be concluded between the player and the club for the provision of his services will be excluded.

For the registration and valuation of intangible assets the Accounting and Auditing of Accounts Institute published in 2013 the following information regarding those rights:

- 'The amortization term will be the duration of the employment contract concluded with the Player, and might be extended in case the Player is renewed before its expiry, without prejudice of the obligation to register the corresponding Impairment correction when recoverable value of the right is less than its book value.
- The asset will be written off on the balance sheet when the player is transferred or leaves the team for any circumstance, such as when the so-called buy-out clause becomes effective, in which case the corresponding result may occur.
- In case of renewal, the amounts that imply a higher remuneration to the player will be classified as staff costs, without prejudice to the fact that, to the extent that they are pending, they should be recorded as an advance under the heading "Non-current trade

receivables" in the balance sheet.

This same criterion will apply to the acquisition of the player's or coach's image rights, which will be charged to the profit and loss account according to their nature as the economic benefits derived from the contract are received.

- Amounts delivered as "down payments" to future players will be accounted for as an advance on intangible assets.
- In no case will the training expenses of the players who come from the institution's youth teams be recognized as intangible assets.'

The tax authorities acknowledge that when a club wants to acquire a player, the amount the former club receives is paid by the new club when a transfer occurs or by the player himself when the buy-out clause is used, although it is true that the latter amount is usually (almost in every single case) given to the player by the new club. In any case, without regard to where the money comes from, it is through the payment of that concrete amount that the new club acquires the federative rights of the player without which the player would not be able to be registered.

Taking all of the above into account the Spanish tax authorities concluded that considering the economic conditions of both payments, whose final aim is to allow the player to be transferred, any amount paid by the new club to acquire the federative rights of a player shall be treated as an intangible asset, which will have the same nature in both cases.

### Personal income tax

For the sake of completeness I will transcribe the full text of Article 16.1 of the Spanish Act 1006/1985, which establishes that: 'One. - The unilateral termination of a contract for the will of the athlete, without just cause, will grant the Club a compensation that in case of no agreement, will be determined by the Ordinary Labour Courts taking into consideration the sporting circumstances, damages caused to





the Club, reasons of termination, and any other elements that the deciding Judge may deem appropriate.

In case that the Athlete, within one year from the date of termination, concludes an agreement to render his professional services to any other Club or Sports Entity, the latter will be a subsidiary responsible for the payment of the pecuniary obligations indicated.'

As can be seen, the compensation that a player has to pay is legally configured as an obligation of the player, with the new club exclusively having a subsidiary responsibility in case of non-payment by the player provided that the contract is concluded within one year after the termination.

Given this scenario established under the Personal Income Tax Law and in order to answer the consultation presented by La Liga, the Spanish tax authorities differentiated between the two different issues:

- On the one hand, the payment of the compensation to the former club being the player's obligation, and
- On the other hand, the delivery of funds to the player by the new club in order to pay such compensation.

Regarding the first issue, whether payment is made by the player with his own resources or after having the money delivered by the new club on behalf of the player, being that the obligation is on the player, the tax authorities considered that for the latter the payment of the buy-out clause will be considered a patrimonial loss, that will be included in the general tax base. In regards to the second issue the fact that a third party finances or assumes the payment of the compensation that has to be paid by the player, would require him to have obtained an income that might be subjected to personal income tax.

In order to qualify such income as a salary or as a patrimonial gain, the tax

authorities applied commercial Spanish regulations, which, for accounting purposes, consider every payment made by a club or sports entity for the acquisition of a player's federative rights as an investment and not a personnel expense. As such, when there is an agreement between clubs transferring the federative rights of a player, the scope of the payment of the buy-out clause is the acquisition of the player's federative rights by the new club, which implies that the amounts paid shall be considered as an intangible asset for the club or sports entity acquiring them.

Therefore, in the words of the tax authorities: "the payment to the Player of an amount equivalent to the amount of the buy-out clause does not respond to a remuneration purpose that could make us understand that we are facing a consideration that derives directly or indirectly from a current or future employment relationship."

It is therefore understood that a payment made by a club to acquire an intangible and economically valuable asset such as a player's federative rights is necessary to determine that for the purpose of the calculation of the player's personal income tax that payment has to be taken into consideration according to its true nature and, therefore, should be classified as patrimonial gain, in accordance with Article 33.1 of the Personal Income Tax Law. 'Variations in the value of the taxpayer's assets evidenced by any changes in their composition, will be considered patrimonial gains or losses, unless they are classified as income by this law.'

Considering all of the above, the patrimonial gain of the player (provision of funds by the new club or the payment by the latter of the buy-out clause to the former club on the player's behalf) is compensated by the patrimonial loss of the same nature whose aim is for the new club to acquire the federative rights of the player. The result of this operation is that the general tax base of the player will not change and therefore no

personal income tax will have to be paid for the payment of the buy-out clause.

#### VAT

In respect of whether there is an obligation to pay VAT in the enforcement of the buy-out clause, the tax authorities stressed that the obligation to pay the compensation in case of unilateral termination of a contract corresponds to the player, even if the common practice is that the new club assumes the payment whether paying on behalf of the player or giving the player the money.

#### The subjective part of the tax

In the Spanish VAT Law (dated 1992) the operations subjected to it are those consistent with the supply against payment of goods and services rendered in the spatial scope of the tax by employers or professionals, on a regular or occasional basis, in the development of their business or professional activity, even if they are carried out in favour of the partners themselves, associates, members or participants of the entities that perform them.

In the same vein, 'employer or professional' are those persons or entities that carry out a business or professional activities defined as those activities that involve the self-management of material or human factors of production in order to intervene in the production or distribution of goods or services or the independent exercise of a profession, art or craft.

Considering that a player is a physical person and not a business, the tax authorities also reiterated that Article 7.5 of the Law establishes that which will not be subject to the tax, which includes 'the services provided by physical persons under a system of dependency derived from administrative or labor relations, including in the latter those with Special character.' At this point we have to bring the reader back to the Spanish Act 1006/1985 whose scope is the regulation of professional athletes' employment relationship, considered by Spanish law as a special

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character employment relationship and therefore not subject to VAT.

#### **The objective part of the tax**

With respect to the analysis of the objective part of the tax, it relates to whether the payment itself is subject to tax. In cases of the termination of an employment contract between a football club and its players it is necessary to establish if the amounts that the club receives as compensation are subject to VAT. In this sense, the tax authorities have reminded the industry that it was established in 1997 (in response to another binding consultation) that those payments are not subject to VAT according to Article 78 of the same Law, which clearly establishes the amounts that cannot be included in the taxable base of operations: '1. The amounts received as compensations that, other than those referred to in the previous section, which by their nature and function, do not constitute consideration or compensation for the supply of goods or services subject to the Tax.'

And in application of the ruling rendered by the European Union Court of Justice in 1996 and 1997, in cases C-215/94 *Mohr* and C-384/95 *Landboden* respectively, in which it was established that in respect of the existence or not of a supply of goods or the provision of services subject to VAT in the case that the compensation is

paid by a third party, the new club, and regardless of the condition of the player as employer or professional under the VAT rules since he has an employment relationship with the club, whether the operation is subject to such tax needs the existence of an actual act of consumption, therefore operations that do not grant a concrete advantage to the addressee which determines an act of consumption are not subject to VAT.

It also has to be considered that the criteria used by the CJEU in 1994 C-16/93 *Tolsma*, where it was established that a provision of services is only made "against payment" in the sense of Article 2.1 of the Sixth VAT Directive, and hence subject to VAT, when between the provider and the provided exists a legal relationship within which they exchange mutual obligations and the payment received by the provider is the effective value of the rendered service.

Considering all of the above, the only conclusion available is that the amount of compensation paid by the player (or on his behalf) to the former club does not constitute any monetary compensation for an operation subject to VAT that the player could perform in favour of his new club. For the sake of clarity, the payment received by the player to be paid as compensation to the former club is not the effective value of the rendered service

(the player's salary will be that value).

#### **Conclusion**

From now on, any club, Spanish or not, interested in the acquisition of a football player (the law and the consultation is analysed from the perspective of any professional athlete, but the sport where buy-out clauses are used most is football), will have to take into account that the payment of such clauses will not be taxed under Spanish law, neither VAT nor personal income tax, something that will create some bizarre scenarios i.e. the payment of a buy-out clause could be cheaper than the payment of a transfer fee. As an example, the payment of a buy-out clause of €50 million is now cheaper than the payment of a €42 million transfer, since the latter will be charged with a 21% VAT, which equates to an extra cost of €8.82 million.

It was always considered an abuse to apply the payment of personal income tax to the payment of a buy-out clause because it significantly increased the cost of the operation. From almost every point of view, the payment to the player, or on his behalf, of such an amount could not be considered as an income for the player since (from the new club to the player and from the player to the former club) the payment passes via the player for such a short amount of time that it does not generate any benefit.

1. <http://www.iusport.es/images/stories/opinion/guillermo-amilibia-tributacion-javi-martinez.pdf>