Playing the new game

Personal tax



30 September 2021

Damien Bailey and Lee Stott consider how to tax the virtual world of e-sports

Key Points

What is the issue?

Tax in the e-sports world is similar to that of traditional sports, but still presents its own unique challenges that businesses or individuals looking to enter into e-sports should be aware of.

What does it mean to me?

As e-sports become more mainstream, organisation levels within e-sport teams are at or edging closer to that of other professional sports teams, where the team acts as a business, seeking profit through various sources such as prize money, sponsorships, advertising and merchandising.

What can I take away?

If you have clients who are looking to engage with individuals or teams within the e-sports industry, whether directly or through an intermediary, you may find that there are tax challenges that they have not considered and will require specialist support.

E- sports athletes are not alone in earning income from such sources. The title ‘streamer’ is given to an individual who may not necessarily be skilled enough to compete in competitions but is able to entertain whilst playing video games. Whether or not this income is subject to tax or NIC will depend on the age-old question of whether it is profit derived from a trade, profession or vocation and taxed via self-assessment as self-employed income.

The profits of a trade are given a wide definition under Income Tax Act 2007 s 989. However, following the case of Ransom v Higgs [1974] STC 539 this is more commonly considered to mean ‘operations of a commercial character by which the trader provides to customers for reward some kind of goods or services’.

The country where the platforms are resident should also be noted (for services such as YouTube and Twitch, this would be the US). Countries may enforce their own withholding regime, which may either require the individual to complete forms to restrict such tax rates to a rate enforced under treaty (i.e. a W8-BEN for payments from the US) or file a tax return to claim relief under treaty.

Where a treaty exemption does not exist or the treaty instead enforces a lower tax rate, a foreign tax credit would likely be available for the individual to offset against UK tax on the same income.

Non-resident

Individuals who are non-UK tax resident but perform a relevant activity in the UK as a sportsperson or entertainer (performer), under Income Tax (Trading and Other

Income) Act 2005 s 13 are deemed to be performing a trade for tax purposes; and profits arising from these performances are subject to income tax.

The definition of performer is vague, as it covers any individual who is performing in their name or character and their performance will be viewed by any section of the public.

Relevant activity is also given a broad definition in that it covers activity by an entertainer or sportsperson in the UK on film, videos, radio or television. ‘Film’ in this case can cover any sequence of one or more visual images, either moving or still. As e-sports performances are mainly broadcast online via services such as Twitch or YouTube, such broadcasts (whether live or not) could be said to be within the definition of ‘relevant activity’.

An obligation to withhold tax may arise under legislation aimed at ‘entertainers and sportspersons’ in cases where:

- a non-UK resident individual is awarded prize money in a UK based gaming competition; or
- a UK business is sponsoring or paying an e-sports star who is non-UK tax resident to endorse their product or service.

The regulations for the withholding regime can be found in SI 1987/530 and this is commonly known as Foreign Entertainers Unit (FEU) withholding (named after the specialist team at HMRC that is responsible for its administration).

Foreign Entertainers Unit regime

Under the FEU regime, payments for ‘relevant activities’ to non-UK tax resident performers, as outlined above, are subject to withholding at the basic rate of tax. The FEU regime also covers expense payments and non-cash payments on a grossed-up basis.

The intention of the legislation is to ensure that foreign entertainers or sportspersons, likely including e-sports performers, are subject to UK tax arising on income derived from their UK performances. This may also cover payments for endorsements or sponsorships if there is a connection (either direct or indirect) with their UK performances.

This was highlighted in Agassi v Robinson (Inspector of Taxes) [2006] UKHL 23. Andre Agassi (a former professional tennis player) argued that as neither he nor the payers involved (Nike and Head) were UK based, endorsement payments from Nike and Head were exempt from UK tax. The House of Lords disagreed and confirmed that there is no territorial limit to the legislation. They found that foreign entertainers who earn income from sponsorship or endorsement activities through their professional activities that include the UK are subject to tax under this legislation.

While in this case and at the time it was not expected that Nike or Head would operate FEU withholding, UK businesses and individuals should be aware of their potential reporting and withholding obligations in similar circumstances.

An e-sports performer may also receive income from other sources, such as streaming, Patreon, donations, etc. Whilst this has not yet been tested at tribunal or court given the infancy of the industry, given the facts of the Agassi case, such income may also be deemed to fall under the FEU regime where it can be linked to UK e-sports relevant activities.

There are a few exceptions to the regime, such as where all payments to an individual are below the personal allowance (even where the individual may not be entitled to the allowance) or payments to anyone on the middleman scheme. It should also be noted that if a payment falls within Income Tax (Earnings and Pensions) Act 2003 as earnings from employment, then it will be subject to PAYE and not FEU withholding.

However, an understanding of the statutory residence test is not expected by the fee payer; i.e. where there is doubt, then HMRC would expect FEU withholding to be operated.

Overall FEU legislation is relatively wide with regards to which payments and which performers may fall within the regime. HMRC has not updated its guidance to specifically mention e-sports, but there are clear parallels with traditional sports and entertainment, and therefore it is likely that HMRC would view e-sports to fall under FEU.

Double tax treaties, should they follow the OECD model treaty, will typically have an ‘Entertainers and Sportspersons’ article (article 17 under the OECD model treaty) that will override other articles for income that arises in respect of their activities as

a sportsperson or entertainer. This ensures that the contracting state other than the state of residence has the right to tax such income where it can be linked to performances in that contracting state; e.g. HMRC having the right to tax income of an e-sports star tax resident in the US but performing e-sports relevant activities in the UK.

One e-sport aspect that does differ from traditional sports is that of relevant activity. Even if the individual is part of a team, their performance can be done remotely with participants in a UK based competition potentially never setting foot in the UK. Due to this, a key question under Article 17 is where income arising from such activity is deemed to be sourced; i.e. whether this should be:

- in the country where the competition takes place;
- where the individual performs their activity;
- where the servers hosting the competition are located; or
- where the game publisher is resident.

Logic (although not yet tested in the courts) would state that the source remains in the state the activity is physically performed. However, opinions may change in the future and tax legislation in various territories along with double tax treaties may adapt to the online and evolving remote working world.

Employment status and tax

As e-sports become more mainstream, organisation levels within e-sport teams are edging closer to other professional sports teams, where the team acts as a business, seeking profit through various sources such as prize money, sponsorships, advertising and merchandising.

How a team collaborates to receive their income streams will likely differ according to how they would receive income as an individual:

- They could work together as a partnership and would then need to consider how profits are shared amongst members. There may be a mismatch in how partnerships or other entities are taxed in other countries (transparent vs opaque) if team members are spread out internationally.
- If the team incorporates, profits for the company would be subject to corporation tax instead of income tax and any foreign taxes paid on income paid to the company would likely only be available as a foreign tax

credit to the company and not the individual.
- Corporate residence or permanent establishment of the entity may need to be considered where team members perform their duties outside the UK.

Teams may then look to engage other e-sports performers to join their team. In traditional sports, the athletes are typically either individual figures (i.e. golf, tennis or boxing) or part of a team who compete together (i.e. football, cricket or rugby). Generally speaking, if individuals are providing their services to a team then for tax purposes they are likely to be considered employed by their team as opposed to self-employed.

Whether or not an individual is employed or self-employed will of course depend on the facts of the engagement. However, where individuals are considered to be employees of a UK team or business, their remuneration will be classed as earnings and subject to PAYE and Class 1 NIC.

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It is not just professional e-sports teams that need to consider how they engage with e-athletes. Other organisations may want to use such stars to endorse their products or services or provide sponsorship and they will also need to consider employment status and potentially operate PAYE and Class 1 NIC on payments, even where the engagement is not directly with the individual (i.e. IR35 or agencies legislation).

International

Given that the barrier to entry in e-sports is a console, gaming PC or mobile phone and an internet connection, it may be the case that a number of professional e-sport teams have no presence in the UK beyond UK resident team members. An obligation to operate a payroll and withhold PAYE and Class 1 NIC may still arise if the team is considered to have a ‘taxable presence’ in the UK.

HMRC generalises this as having an address in the UK in which it can enforce compliance. If a team was to inadvertently create a permanent establishment in the UK as a result of their UK resident employees’ activity, then this would more than likely create an obligation (amongst other implications that arises with the creation

of a PE) to register as an employer and withhold PAYE and Class 1 NIC.

Similarly, UK businesses engaging with e-sports stars internationally may need to consider their potential risks and obligations in the country the individual resides and performs their services in.

A further consideration arises if a professional e-sports team is based in the EU, as Annex SSC-14 of the EU-UK Trade and Cooperation Agreement states that employers will have a presence for social security contribution purposes in the UK or EU member state that their team member is subject to social security (typically where they perform their duties). In such a case, while no obligation may arise for PAYE for a non-UK business, a payroll would need to be operated on behalf of the employee to withhold Primary Class 1 NIC and pay Secondary Class 1 NIC.

Going forward

Once the industry begins to mature, how to manage image rights in a tax efficient manner may become a point to consider for individuals and engagers alike. Recently, it has been reported that Hashtag United has been offered a fee for one of their professional FIFA players (tinyurl.com/xz2kch9a). This is believed to be the first of its kind and a demonstration that organisations are looking for opportunities to tap into the social media brands of high profile e-sport stars. A football club making a star signing is likely to be looking not only at the player’s skills on the pitch, but also for the opportunity to exploit the huge brand the player has developed over their playing career.

Summary

If you have clients who are looking to engage with individuals or teams within the e-sports industry, whether directly or through an intermediary, you may find that there are tax challenges that they have not considered and will require specialist support.

Those with a strong knowledge of taxation for sportspersons or entertainers will have a good grounding in the growing e-sports industry. For others, there are many areas that will be new to them and over the next few years as the industry grows, legislation and case law may shape it further so that e-sports becomes its own niche area of taxation.