

# The Fishy Business of Sports Sponsorship and Tax Deductions

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When a business makes sponsorship payments, that expense can be deducted from the sponsor's income when it is calculating its tax liability, right? Well, no, not always, as Plymouth-based Interfish Ltd has found out to its (substantial) cost. A recent Upper Tribunal decision upheld the First Tier Tribunal's conclusion that Interfish's sponsorship payments to a local rugby club, Plymouth Albion, did not qualify as tax deductible expenses, thereby increasing the amount of tax that Interfish owed to HM Revenue & Customs.<sup>1</sup>

Interfish had sought to deduct £1.2m of sponsorship payments that it had made to Plymouth Albion when calculating its profits for the purposes of corporation tax for periods ending January 2003, 2005 and 2006. The extra tax that would be due to HMRC if the sponsorship payments were not deductible (as a result of the increase in profits for tax purposes) was approximately £300,000. Hardly small fry. Interfish had contended that the payments were deductible; the FTT held they were not. Interfish appealed on the basis that, in reaching its conclusion, the FTT had made an error of law. The Upper Tribunal heard the appeal in May 2013.

## Interfish and Plymouth Albion

Interfish is a fishing, fish processing, fish wholesaling and fish retailing business based in Plymouth. It is a major employer in Plymouth and a significant business in the south west of the United Kingdom. Interfish is wholly owned by Mr Jan Colam and a family trust, which was controlled by Mr Colam. It was therefore common ground before both the FTT and the Upper Tribunal that Mr Colam's state of mind amounted to the state of mind of Interfish itself.

Plymouth Albion is a rugby club also based in Plymouth. During the relevant years, when the club was one of the largest clubs in the south west and played in the RFU's National Division 1, Interfish made several sponsorship payments to Plymouth Albion. Interfish treated those amounts as deductible amounts in its accounts under the heading *Advertising and Marketing*. The sums paid represented between 1 per cent and 3 per cent of Interfish's turnover.

Mr Colam became heavily involved in Plymouth Albion in about 1999. At that stage, the club was in severe financial difficulties and, when it incorporated, Mr Colam was invited to join the board. Mr Colam also subscribed for shares in the club. Given the club's difficulties, other sponsors of Plymouth Albion would not increase their contributions; Interfish, however, was prepared to be more generous. Mr Colam wanted to be established in the business community in Plymouth and to have the value of the business connections that the club afforded.

During the relevant period, Interfish advertised its *South West Seafoods* brand on a perimeter hoarding at the club's ground and also on the players' shirts. In addition, the logo was included on each page of the club's website, and Interfish also used the club's facilities for business hospitality. Interfish also lent money to the club and made substantial payments to cover what would otherwise have been a deficit in the club's player budget. For example, Interfish's first sponsorship payment was to enable the club to recruit Graham Dawe, a former Bath, England and British and Irish Lions player, as its Director of Rugby.

In addition to the visible promotion of *South West Seafoods*, there were other benefits (albeit non-tangible) to the sponsorship payments. For example, Interfish was perceived by Mr Colam to benefit from an improved relationship with its bank. The local Regional Corporate Director of the NatWest Bank had been closely involved in the running of Plymouth Albion and it had been accepted by the FTT that Mr Colam's role at the club, together with Interfish's financial support of and loans to the club, was perceived by Mr Colam as likely to earn Interfish the goodwill of that Regional Corporate Director. Overall, there was no dispute that Mr Colam and Interfish did indeed obtain significant influence in the community through being the club's major sponsor in a way which could not have been achieved by Mr Colam simply participating as a director.

## Tax legislation and cases

As highlighted in *HMRC v Healy*,<sup>2</sup> the tax deductibility of expenses can be a tricky issue. As a UK resident company, Interfish was liable to corporation tax on the profits of its trade. It was permitted, when calculating the profits that were to be charged to tax, to make certain deductions from its accounting profits. However,

<sup>1</sup> *Interfish Ltd v HMRC* [2013] UKUT 0336 (TCC).

<sup>2</sup> *HMRC v Healy* [2013] UKUT 337 (TCC) and Aredhel Johnson, "When the tax deductibility of expenses takes centre stage" (2013) 24(8) Ent. L.R. 292–294.

it was not permitted to deduct amounts of expenditure which were not “wholly and exclusively laid out or expended for the purposes of the trade”.

This rule contains two discrete tests. First, the expenditure needs to be “wholly” incurred for business purposes. This refers to the quantum of payment, and no issue about that aspect arose on the appeal. The second aspect was that the expenditure was “exclusively” incurred for business purposes. Essentially, this requires that the business purpose must be the sole reason for the expenditure. Expenditure for a dual purpose, where one is a business purpose and the other is not, falls outside this provision and cannot be deducted from the profits charged to tax.

### The FTT decision

The Upper Tribunal recounted the FTT’s decision before considering the nature of the appeal. The FTT (and later, the Upper Tribunal) reflected on a couple of decisions of the Special Commissioners (although they were not binding on the Tribunals) which concerned the deductibility of sponsorship payments. The first was *Executive Network (Consultants) v O’Connor*,<sup>3</sup> where the taxpayer company sponsored the equestrian activities of a member of the family of one of the shareholders with a view to promoting the company through its participation in the equestrian events. In that case, the expenditure was held not to be tax deductible. In contrast, in *McQueen v HMRC*,<sup>4</sup> the expenditure incurred by Mr McQueen (a sole trader) in competing in motor rallies in a rally car decorated in the livery of his own motor coach business was deductible from his profits for tax purposes.

In respect of the Interfish payments to Plymouth Albion, the FTT concluded that Mr Colam’s position as the benefactor of the city’s rugby club would have given him a particular status among those in the local community who were aware of it. Those people would have included business and professional people who frequented the club (such as the NatWest director). The FTT therefore considered that Mr Colam was generally aware of the possibility that those people would have been favourably disposed towards Mr Colam and Interfish when Interfish embarked on the series of sponsorship payments to the club. According to the FTT, Mr Colam would not have made the payments if he had not anticipated benefits of that sort for Interfish.

Crucially, the funds provided by Interfish were tailored to Plymouth Albion’s reasonable requirements for players and contributing them formed part of Mr Colam’s plans for the club. On the basis of Mr Colam’s evidence, the FTT found that, in Mr Colam’s mind, it was a reasonably held expectation that those involved with Plymouth Albion would in return look favourably upon Interfish in ways that would assist Interfish’s trade and that it was also Mr Colam’s purpose to achieve that.

As a result, the FTT found that Interfish’s purpose in making the payments could, at best, be stated as being to improve the financial position of the club (in particular by enabling it to enhance its squad of players without incurring a deficit), in order that those involved with the club would look favourably on Interfish in ways that would assist Interfish’s trade. The FTT found that improving the financial position of the club in that way was therefore a conscious purpose in the mind of Mr Colam (and therefore Interfish) when the payments were made.

The FTT then went on to consider the relationship between that conscious purpose and the benefits to Interfish of making the payment. In short, the FTT could not see how the furtherance of the club’s trade could be dismissed as merely a consequential or incidental effect of the sponsorship payments. The promotion of the business of the club was not an unintended consequence of Interfish’s payments; it was a consciously intended consequence and, indeed, necessary if Interfish were to benefit from the sponsorship arrangement. Contrasting Interfish’s situation from that in *McQueen*, Mr McQueen’s enjoyment of the rally driving was not the purpose but merely an incidental effect—much like paying a wage to another driver if one had been employed. The Interfish payments were, if anything, more like the payments in *Executive Networking*, which had been tailored to the requirements of the equestrian pursuit.

The FTT considered that the requirement of “wholly and exclusively ... for the purposes of the trade” was a restrictive one. It would be surprising if the provision allowed the deduction of sums that were laid out for the immediate purpose of promoting the trade of someone else, even where there were real (albeit intangible and hard to quantify) knock-on benefits to the taxpayer’s trade. In conclusion, the FTT had held that, whilst there were some sums that were deductible, such as payments in respect of advertising space at the hoardings at the ground (which had been separately paid for), the sums paid by Interfish for purposes such as increasing the club’s player budget were not deductible.

### The appeal to the Upper Tribunal

The right of the appeal from the FTT to the Upper Tribunal is on any point of law. If the Upper Tribunal found that an error of law had occurred then it may, although is not required to, set aside the decision and could either remit the case to be reconsidered by the FTT or remake the decision itself.

The Upper Tribunal recounted numerous cases which dealt with the “wholly and exclusively” test, several of which highlighted the difficulties that arise in practice with the test which refers to a sole purpose in circumstances where there are two possible motives or purposes in play. The way in which the law distinguishes between situations which appear to have more than one

<sup>3</sup> *Executive Network (Consultants) v O’Connor* [1995] Sp. C. 56.

<sup>4</sup> *McQueen v HMRC* [2007] Sp. C. 601.

purpose is by focusing on the taxpayer's subjective intentions. A judgment must be made about that matter, which is a matter of fact.

The Upper Tribunal noted that the FTT had found, as a matter of fact, that one of Interfish's purposes in making the payments was to benefit Plymouth Albion. That was a finding which was, according to the Upper Tribunal, "plainly open" to the FTT to make on the basis of the evidence which it had been presented.

Interfish's submission on the appeal to the Upper Tribunal was that the *ultimate* purpose of the sponsorship payments was and always had been to benefit Interfish, with the benefit to Plymouth Albion a consequential, incidental effect. As a result, that ultimate benefit to Interfish should result in the payment being deductible in law. HMRC, unsurprisingly, supported the FTT's decision that, as a matter of fact, Interfish had two purposes in making the payments and therefore the payment was not "exclusively" for the purposes of the trade. Indeed, as improving the financial position of the club was a conscious purpose in the mind of Mr Colam, HMRC suggested the finding of the FTT was inevitable.

The Upper Tribunal rejected Interfish's argument that the payments were deductible, as seeking an immediate objective (i.e. improving the club's financial position) was in order to obtain an ultimate objective (namely the promotion of Interfish). This distinction did not arise in the statute nor the case law. The question for the Tribunals to decide was simply whether Interfish's actual purpose was "exclusively" a business purpose. If not, then the test would not be satisfied and the amount would not be deductible.

According to the Upper Tribunal, if a purpose is pursued with a view to another purpose, then both purposes must be in view. If one of them is not a relevant purpose within the tax legislation, then the payment will not be deductible. A different situation would have arisen had Interfish had only one purpose in mind—however, that was not the case.

The Upper Tribunal concluded that, from the evidence, it was clear that Mr Colam's conscious purpose of improving Plymouth Albion's financial position was so that Interfish's commercial interests would be furthered in consequence. This was plainly true on the FTT's findings, and the improvement of Plymouth Albion's finances could not be relegated to something that was merely consequential and incidental. As the FTT had held, improving the club's finances was not an unintended consequence of Interfish's payments; it was intended. Both purposes were therefore in view and, as a result, the payments were not "wholly and exclusively" for the purposes of Interfish's trade. The appeal was dismissed with the FTT's decision upheld.

## What next for corporate sponsorship?

During the Upper Tribunal hearing, Interfish had suggested that the case was "being watched by those concerned with corporate sponsorship" and that the

"decision had important implications in that sphere". However, given the unique circumstances in *Interfish*, such as Mr Colam's position as the sponsor's controlling shareholder (and for all intents and purposes, Interfish personified) coupled with his role as shareholder and director at Plymouth Albion, this decision is unlikely to concern too many sponsors.

The decision does, however, show that a sponsor providing payments on the basis that they are used for specific items of expenditure, such as the recruitment of Graham Dawe, points towards patronage rather than sponsorship, which will fail the "exclusively" test. Whilst the success of a sponsored entity will be of huge importance to a sponsor (after all, few businesses will be keen to be associated with an unsuccessful sporting enterprise), the influence that Mr Colam had on Plymouth Albion, whilst not so sufficient to render the payments as non-arm's length expenditure, was enough to ensure that the benefit to the club was inevitably part of the purpose of the payments being made.

As a sponsor, providing amounts that can be justified by the benefits received, such as paying the going rate for advertisements, player appearances, websites etc., is much more likely to result in those payments being tax deductible (as indeed Interfish's payment to the club for the advertisement on the ground hoardings was). Linking the payments to the recipient's financial situation and its own intended expenditure adds a second purpose to the making of a payment and can result in it falling foul of the "exclusively" test.

The *Interfish* decision may be a useful tool for sponsored entities when dealing with sponsors who seek to attach conditions to payments or insist how a club should spend the money it receives pursuant to its sponsorship arrangements. Gently reminding such sponsors that they risk prejudicing their own corporation tax position by making such demands may be sufficient to ensure they are happy to be kept out of the sponsored entity's decision making processes.