1. Amazon - introduction

This tech giant, who started as an online bookstore, is now the largest Internet-based retailer in the world. Since its founding, Amazon has attracted criticism and controversy from multiple sources over its actions. This brief article presents the three stages through which Amazon's had to go in order to defend its tax position after hearing allegations from the Public Accounts Committee of the UK Parliament, the US Internal Revenue Service, and the EU Commission respectively.

2. Stage A[1]

At a hearing of the Public Accounts Committee of the UK Parliament on November 12, 2012, the directors of public policy for Amazon was subject to an interrogation, where it was suggested that Amazon is engaged in shifting income out of the UK to tax havens, such as Luxembourg.

Amazon, despite having a British subsidiary, pays much of its corporate tax in Luxembourg, where its European HQ is located. Much of the hearing focused on the complexities of Internet commerce in the global marketplace, with Amazon claiming their European business is conducted by a single pan-European trading company in Luxembourg while affiliates in various EU countries, including the U.K., were merely services providers to the Luxembourg trading company. Those claims were counter-attacked by the lawmakers who highlighted that the entire economic activity of warehousing, marketing and selling of Amazon is in the UK.

The following video documents the above hearing:

https://www.youtube.com/watch?v=cETKO42wMOs

3. Stage B[2]

In the same month, the Internal Revenue Service has accused Amazon for abusing its transfer pricing policy to migrate profits (generated in the United States) out of the country. The IRS has handed Amazon a tax bill of $234 million for 2005-2006, as it was contesting the calculations of cash transfers between Amazon Luxembourg and its European subsidiaries. The IRS was of the opinion that Amazon has grossly undervalued intangibles transferred to its affiliate in Luxembourg and undercharged the affiliate for its share in the cost-sharing arrangement. Where Amazon valued the transferred intangibles at $216 million, the IRS claimed that they were actually worth $3.6 billion.

Ultimately, in March 2017, in finding for the company, the court agreed with Amazon that the U.S. cost-sharing regulations do not require payment for pre-existing intangibles in perpetuity. However, IRS has decided to appeal the Tax Court decision to the Ninth Circuit Court of Appeals.

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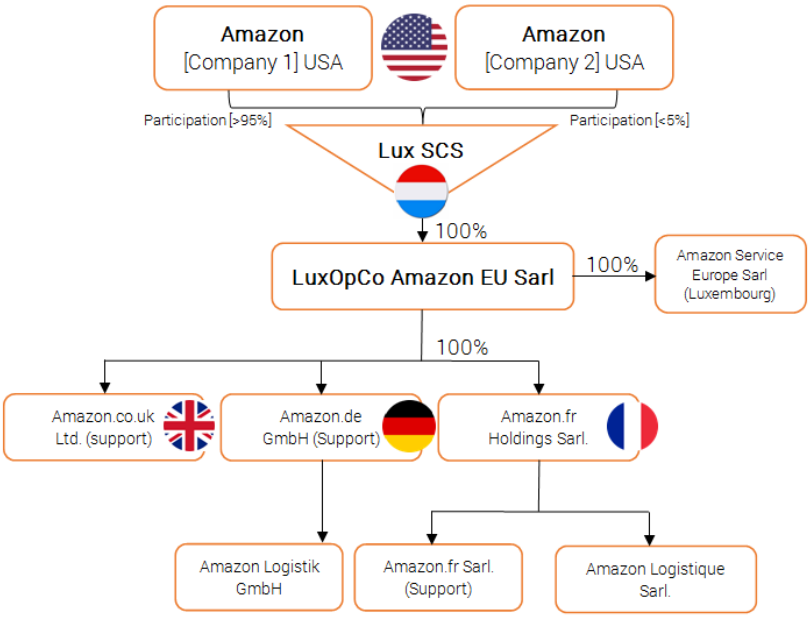
[1] *Link to Bloomberg Article:* https://taxandaccounting.bna.com/btac/T11500/split_display.adp?fedfid=28631948&vname=tmtrnot&wsn=516310000&searchid=30681838&doctypeid=13&type=date&mode=doc&split=0&scm=T11500&pg=0; *Link to "The Guardian" Article:* https://www.theguardian.com/business/2012/nov/12/amazon-google-starbucks-diverting-uk-profits

[2] *Link to Bloomberg Article:* https://taxandaccounting.bna.com/btac/T11500/split_display.adp?fedfid=107884128&vname=tmtrnot&wsn=501798000&searchid=30681844&doctypeid=13&type=date&mode=doc&split=0&scm=T11500&pg=0

Even though Amazon prevailed in a dispute over the pricing of its European operations, it may still face additional tax bills in Europe if the Commission conclude that prior rulings by Luxembourg tax officials amount to improper State aid as discussed in Stage C.

4. Stage C[3]

On October 4, 2017, the EU Commission accused Luxembourg government of providing State Aid to Amazon Luxembourg, where certain transfer pricing arrangements were qualified as "artificial" and "in a subjective manner benefiting Amazon as a taxpayer".



The case involves a royalty paid by one Amazon Luxembourg subsidiary, acting as an operating company to a holding company. The holding company is a "hybrid" entity, which is seen as a partnership under Luxembourgish law, whereas it is treated as a corporation for U.S. tax purposes (under the so-called "check the box" mechanism). Under the Amazon structure, only minimal profits were reported outside Luxembourg due to Amazon LuxOpCo principal setup. Profits were then shifted from LuxOpCo to Lux SCS (partnership) via license fee, which resulted in no tax being levied on the profit due to afore-mentioned tax rules mismatch. The untaxed profits were then further redistributed to Amazon companies via loans.

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[3] *Link to Bloomberg Article:* https://taxandaccounting.bna.com/btac/T11500/split_display.adp?fedfid=122777830&vname=tmtrnot&wsn=500162000&searchid=30681846&doctypeid=13&type=date&mode=doc&split=0&scm=T11500&pg=0

Source: *State aid: Commission finds Luxembourg gave illegal tax benefits to Amazon worth around €250 million*, European Commission - Press release, 4 October 2017.

The Commission highlighted in its investigation that the level of the royalty payments was inflated and did not reflect the economic reality. This favourable tax ruling has put Amazon in an advantageous position comparing to other companies which are subject to the same national tax rules and has enabled Amazon to avoid taxation on three quarters of its profits from sales in the EU.

As the EU Commission has found this practice to amount to an illegal State Aid, it ordered Luxembourg to collect approximately 250 million EUR worth of back taxes from Amazon. It is expected that the Commission's decision will be appealed all the way up to the ECJU, leaving the final decision uncertain for many years to come.

5. Conclusion

As presented in the three stages, Amazon has attracted a lot of criticism from multiple sources over its actions in the last couple of years. Despite its small victory in the dispute with the IRS, Amazon has come under fire for avoiding paying taxes on its British sales. The grilling by the Public Accounts Committee of the UK Parliament has caused a lot of reputational damages to Amazon. It will most likely be very difficult for Amazon to regain its reputation in the upcoming years after the recent allegations from the EU Commission, especially in the light of a growing culture of naming and shaming of companies that do not pay their fair share of taxes. Therefore, global firms such as Amazon should not only be concerned about the inevitable disputes with tax authorities on their aggressive tax avoidance, but most importantly on the reputational risk side of such practices. It has to be borne in mind that it is much easier to repay the taxes owned, than to repair the damaged image of the company.