Assessing Amazon

International Tax   Large Corporate

01 September 2018

Bill Dodwell considers the impact of Amazon's business in the UK

Amazon has just filed 2017 accounts for two UK businesses: Amazon UK Services, which runs its UK distribution centres and delivery business and Amazon Web Services, which provides consultancy and UK marketing services in relation to cloud computing.

Amazon.com Inc filed its 2017 financial statements in April – and they showed a 2% net profit before tax on the group's $177 billion sales. The group has always made low profits – in the range 0-3% over the last decade. The major part of Amazon's global business is in selling goods and services both on its own account and by selling products from others. Its cloud computing arm, AWS, accounts for about 10% of global sales.

Interestingly, the group's CEO, Jeff Bezos, focused not on profits but on customers in his annual report to shareholders. He noted that Amazon UK has ranked No 1 in the UK's Customer Satisfaction Index from the Institute of Customer Service for the last five years (and eight years in the equivalent US index). The letter never refers to profit – and makes only passing reference to sales in one unit. The letter does refer to enabling third parties – and especially small and medium-sized businesses – to sell via Amazon's platform, including cross-border sales.

> *'Marketplace – In 2017, for the first time in our history, more than half of the units sold on Amazonworldwide were from our third-party sellers, including small and medium-sized businesses (SMBs). Over 300,000 U.S.-based SMBs started selling on Amazon in 2017, and Fulfilment by Amazon shipped billions of items for SMBs worldwide…Our Global Selling program (enabling SMBs to sell products across national borders) grew by over 50% in 2017 and cross-border ecommerce by SMBs now represents more than 25% of total third-party sales.'*

The group's 2017 financial statements reflect a 20% tax charge – but that hides a lot of complexity. The group's US profit before tax was $5.6 billion but it lost $1.8 billion internationally – so its net profit before tax was $3.8 billion. Nonetheless its non-US current tax charge was $724 million, compared to the US charge of $74 million. The US charge has been reduced from the prior year due to US tax reform. The tax charge – both in the US and internationally – is also substantially reduced by tax deductions for employee share payments – which were over $4 billion in 2017.

The group accounts record that $11.3 billion of it sales are attributed to the UK – about 6% of total group sales.

The Amazon UK Services accounts do not include UK sales to customers, as its role is to provide services only to the main UK retailer, Amazon EU Sarl. This Luxembourg company has a sales branch in the UK, as Amazon buyers may have noticed on their invoices. However, it doesn't publish accounts solely for the branch. UK company law requires that the accounts of the whole company be published. We thus don't know how much profit it makes, or tax it pays. However, given the low group profitability and that we know its technology is developed in the US (which no doubt receives a return on it), UK profitability isn't likely to be very high.

The UK distribution company makes a net profit of 4% on its sales of nearly £2 billion (something like $2.5 billion) – twice the group percentage. Its tax charge is just 2%, though, well below the statutory rate of 19%. The accounts explain the difference – which is primarily due to corporation tax deductions for paying employees in shares, partly offset by non-allowable costs. The expected tax charge would be nearly £14 million, but it’s reduced by £17.5 million due to tax relief for employee shares (and increased by £5.8 million for non-allowable costs).

Many companies offer employees part of their income in shares or share options. The difference with many technology-based groups is the scale and value of the awards. As technology company share prices climb, employees do very well. We must always remember, though, that employee tax charges are much higher than corporation tax. Employees will pay income tax at 20%/40%/45%. Most will also pay national insurance at 2%, alongside employer national insurance at 13.8%. The effective rate of tax will be 46-61% – considerably more than 19% corporation tax.

How then should citizens assess Amazon’s contribution to the UK economy? It clearly does deliver substantial amounts of tax – primarily in the form of VAT and Payroll taxes, which must amount to hundreds of millions of pounds. Equally clearly, it has invested over £1.8 billion in UK fixed assets and it employs 20,000 people here. Making higher profits – and thus paying more corporation tax – would mean increasing margins and putting up prices to customers.

Perhaps we also need to consider the other benefits that the company brings. It’s clearly popular with its customers, as its customer satisfaction and sales demonstrate. Its platform is an enabler for others (as are other platforms, too). Major retailers might not sell via Amazon’s platform, but the evidence suggests that an increasing number of smaller retailers find it can expand their potential market. It’s also inevitable that platforms will have an increasing role in tax reporting, compliance and collection.