

MILESTONE

The Amazon Debate  
16 November 2012

Milestone is an independent practice of lawyers specializing in international tax law. In the interests of disclosure, we do not and have never advised Amazon. We do, however, take a keen interest in the issues facing this particular multinational business and those companies currently targeted by MPs, the press, left-wing bloggers and disgruntled competitors.

We agree that the time is nigh for the Government and HMRC to consider a radical overhaul of the UK tax system. It is ludicrously complex, long and in places very badly drafted. However, the populist view that all multinationals are evil, immoral and unjust is not the basis on which a review of the UK tax system should be undertaken. The Public Accounts Committee showed, with alarming alacrity, the ignorance of those running the UK and responsible for setting the future direction of tax policy.

Any debate, tax or otherwise, must be conducted impartially with those involved being well-informed. Unfortunately, perhaps because tax is so complex, but more likely because it is so emotive (especially during times of austerity), much of the current debate has simply ignored established tax principles and instead relied on “soap-boxing” and name-calling.

With this in mind, we thought it would be useful to provide you with a brief tutorial of the tax principles applicable to the Amazon business. Due to the lack of publicly available information on Amazon’s corporate structure, we have had to make certain assumptions about the Amazon business model, but are confident that the structure outlined below is established and governed by the tax principles and laws we have described.

We have attempted to make this Milestone Tutorial as clear and concise as possible, making it accessible to all our readers including newcomers that have, perhaps, never heard of a double tax agreement. Our aim is to re-start the current debate and to stress that despite the use of inflammatory words such as “tax dodger”, “unjust” and “immoral” companies like Amazon have done nothing illegal. The tax principles that multinational companies rely upon are based on established economic theory – principles that have been entrenched in our tax system for at least 50 years. One final comment before we begin in earnest – it is a truism, but Parliament makes the laws by which we are required to abide.

Where it does not consider them appropriate or fit for purpose Parliament alone has the power to amend these laws.

We hope you find this first Milestone Tutorial of interest and look forward to hearing any feedback you might have.

## The (European) Amazon Tax Structure

Our educated guess at the Amazon corporate structure for its European operations is as follows:

- Amazon is an on-line B2C e-tailer;
- Amazon’s European business is Headquartered in Luxembourg;
- The servers on which the Amazon website is hosted are (likely) located in Ireland;
- Amazon.co.uk is a trading name of Amazon EU Sarl, a Luxembourg incorporated company;
- Amazon EU Sarl sells products either as principal or as agent for others;
- When a consumer buys a product via Amazon.co.uk they are buying from Amazon EU Sarl (i.e. a non-UK company);
- Amazon EU Sarl has a UK incorporated subsidiary that operates several warehouse, picking, packing and distribution facilities;
- Other such facilities exist in France and Germany;
- Some goods sold by Amazon EU Sarl will be held in UK warehouses and distributed from there, others will be distributed by the EU warehouses;
- Legal title to the inventory held by the warehouse facilities will vest in Amazon EU Sarl.

## The General Principles of Tax Law Applicable to E-Commerce

Amazon is a fundamentally different business to, say, HMV or John Lewis. First and foremost it is a foreign (i.e. non-UK) headquartered and owned business. Secondly, it is an on-line retailer. Its business is conducted over the internet; customers buy goods via a website / server that is located in a foreign jurisdiction. This is critical to the tax analysis and to understanding any argument put forward to change the way in which companies such as Amazon could or should be taxed.

But, before considering the tax elements in further detail, it is necessary to step back and consider the law

of contract (trust us, it is very relevant to the current debate!). If I go into Starbucks (topical for other tax reasons that we will comment about in a separate Milestone Tutorial) and order a *Grande Soya Latte*, the point of sale (i.e. the offer and acceptance that concludes the contract) is at the till. This is a matter of well-established contract law. Similarly, if I walk 100 yards down Piccadilly to Boots and pick up a packet of *Zantac* priced at £2.99 and take it to the till, I am making an offer to Boots to buy their product. Again, it is their acceptance of my offer that concludes the contract between us.

These same basic principles of contract law apply to on-line businesses such as Amazon. The critical question being, where is the contract concluded. In the case of Amazon, when I log onto Amazon.co.uk (which is a trading name of Amazon EU Sarl, registered to the Luxembourg company) and purchase Season 4 of *Breaking Bad* the mechanics are entirely the same. I am offering to buy the product sold by Amazon, the contract being concluded by the Amazon EU Sarl web servers located outside the UK.

The place of contract is crucial to the tax analysis. The conclusion of the contract will determine whether Amazon EU Sarl is trading in or with the UK. If the contract for *Breaking Bad* Season 4 is concluded in the UK, Amazon EU Sarl will be considered to be trading *in* the UK for UK tax purposes and its profits will then be liable to UK tax.

If, by contrast, the contract for *Breaking Bad* Season 4 is actually concluded by the non-UK Amazon EU Sarl server accepting my offer to purchase, Amazon EU Sarl is trading *with* the UK. By definition, and with over 100 years of case law to support this analysis, Amazon EU Sarl does not have a taxable presence in the UK and its profits cannot therefore be taxed here.

This simple analysis seems to have been largely ignored in the current debate. The general premise seems to be that it's easier to brand a large corporate a 'immoral' than consider the tax and legal principles that govern its economic activities.

## The Distribution Centre

Now that I have had my offer accepted by Amazon EU Sarl, *Breaking Bad* Season 4 (in case you have forgotten), then needs to be distributed to me. I have purchased a DVD from a Luxembourg company – that is not in question. The auto-confirm email I receive from Amazon and my receipt states clearly that my DVD is “**Sold by: Amazon EU Sarl**”. The DVD will be held in one of the various warehouse facilities that Amazon has in the UK, France or Germany. It is most likely the DVD that is shipped to me will be located in the UK warehouse facility as I am a UK customer, but that may not always be the case.

The UK warehouse facilities will likely be owned by Amazon's UK subsidiary. However, just because the order I have placed with Amazon EU Sarl is fulfilled by the UK subsidiary does not mean that the transaction has a UK source (at least for tax purposes). The fact that the DVD owned and sold by Amazon EU Sarl is located in the UK (at the UK warehouse facility) is irrelevant too – at least for tax purposes.

Some might argue that because I have bought a DVD from a co.uk website, which is distributed to me by a UK company, this does (or ought to) mean that the sale should be concluded in the UK or more pertinently (in the mouths and pens of various commentators) that the profit arising from the transaction must be taxed in the UK. Others might argue that Amazon EU Sarl is trading in the UK through the UK warehouse operation, or to put it in tax parlance the warehouse is, in fact, a permanent establishment (**PE**) of the Luxembourg company. For tax purposes, when a foreign company, such as Amazon EU Sarl establishes a presence in a foreign country, either directly or via a third party, that presence (be it an office, warehouse, place of management etc) can become a place of business or PE (taxable presence). If a PE does arise this means a proportion of the profits of the foreign company will be allocated to that PE and taxed accordingly.

In the case of Amazon EU Sarl and its UK warehousing facilities (that it either owns directly or via a UK subsidiary) the critical issue is whether this amounts to a UK PE such that some or all of Amazon EU Sarl's profits should be allocated to, and taxed in, the UK. The answer to this complex question can be found in the Luxembourg/UK Double Tax Agreement (**DTA**).

Article V of the DTA defines a PE and includes the standard OECD definitions, these being:

- a) a place of management;
- b) a branch;
- c) an office;
- d) a factory;
- e) a workshop;
- f) a mine, quarry or other place of extraction of natural resources;
- g) a building site or construction or assembly project which exists for more than six months.

The basic starting premise of the DTA is that Amazon EU Sarl is a Luxembourg company and is therefore subject to Luxembourg tax. Only to the extent it has a PE in the UK should it pay UK tax. As the title suggests, the DTA is designed to prevent double taxation of the same profits.

Article V(3) goes onto explain that the definition of PE shall not include, inter alia:

- a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise.

In terms of warehousing and fulfilment, Amazon as a business could, of course, outsource this to a third party here in the UK. This would not alter the tax analysis as set out above. Amazon chooses to invest in the UK (take the site at Rugeley, Staffordshire, an ex-mining town, that employs 1,500 people) so it can control the delivery of products sold by the Luxembourg company. The UK business will likely be funded by the Luxembourg trading company and the amount paid by Amazon EU Sarl for the services performed by the UK operation will be similar to what Amazon would have to pay a third party. That is to say, the related party transaction will be benchmarked against open-market comparables to ensure the right price is paid. This is a fundamental principle of transfer pricing to which all companies must adhere.

So, whilst *Breaking Bad* Season 4 was sold to me by Amazon EU Sarl, the fact that the DVD was stored in the UK and delivered to me by a UK company does not mean the Luxembourg company's profits are liable to UK tax. Quite the opposite. The double tax treaty the UK has concluded with Luxembourg, which is based on the OECD Model Convention, specifically prevents the double taxation of those same profits.

These elements, particularly the fundamental tax concepts that most countries have accepted and adopted into domestic law, have been almost wholly ignored in the current debate. In our view, this means the debate is ill-considered and based on emotive, rather than intellectual precepts.

## Summary

We hope that this document serves to illustrate Amazon's likely corporate structure. Because Amazon is an international, e-commerce business that has chosen to headquarter its European sales centre in Luxembourg means that profits it generates from sales are taxed in Luxembourg. Luxembourg is the profit centre of its operation whilst the UK, France and Germany are cost centres. The result, as one would expect, is not avoidance as we have been led to believe.

If the naysayers are to have their way such that companies like Amazon are required to pay UK tax on these transactions, not only will the law of contract need to be changed but also UK tax policy and internationally recognised agreements and concepts such as double tax treaties and transfer pricing guidelines. This would require a fundamental re-think of how global transactions should be valued.

Without doubt this is a complex area of tax law. As always with tax, it reflects the trade-off between the promotion of economic development and the desire to raise sufficient revenue to enable a Government to function effectively. Yet aside from this technical balancing act, tax is also a highly emotive topic not least because we are faced with a global financial crisis that means Government spending is falling in correlation to revenue collection.

Our biggest irritation is that the current debate lacks balance and intellectual rigour. Little or no thought seems to have been given by the various MP's and

'commentators' as to the economic outcomes that might result as a result of shifting the tax balance to ensure it is sufficiently UK centric. Were they to follow their logic through to its seemingly inevitable conclusion they may reconsider their position.

This Milestone Tutorial is an attempt to explain how the current UK tax rules apply to an international business and why it would be very difficult to amend these. In our view, the UK tax system is in dire need of a rethink. However, if we do want to change UK tax policy and legislation, we need a real debate, one that is sensible and well informed on all relevant aspects. In the absence of this, the debate is not about tax but simply about (misplaced) immorality or fairness. This cannot be right.

---