Trumps next target, the great tech tax dodge

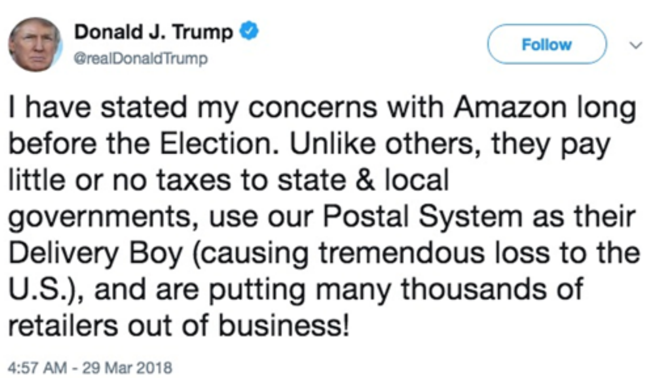
As a general rule, the most successful man in life is the man who has the best information

Donald Trump's enmity towards Amazon and its founder Jeff Bezos, the richest man on Earth, has indeed been going on for a long time, and it's easy to frame the tiff as two billionaires marking their territory like two pit bulls in a fight ring. After all, Trump is a billionaire capitalist too, and it's not as though he hasn't done his fair share of tax dodging.

But the success of Amazon and other giant tech companies - Facebook, Twitter, Google, Apple and Microsoft come to mind - does run up against Trump's vision of America, where jobs are created or brought back to the United States, corporate taxes are kept low and companies pay them, and trade deals are fairly negotiated that do not put US firms at a disadvantage. It's all part of "Making America Great Again". Amazon represents the new economy where commerce is done online, the business is global, and tens of thousands of employees work for Amazon outside of the US.

While Trump has aimed his economic bullets at China, mostly, threatening $150 billion worth of tariffs, and his closest trading partners Canada and Mexico through the renegotiation of NAFTA, he has also brought Facebook and Amazon into the spotlight, the latter through his very public feud with Bezos, and the former due to Facebook's Cambridge Analytica scandal.

With every negative tweet Amazon loses billions. Since [Axios first reported Trump is "obsessed" with the company on March 28,] Amazon has lost $60 billion in market value. The tech-heavy Nasdaq has also been hammered, dragged down by heavyweights Amazon and Facebook, (although it's rebounded since the beginning of April) but also over the perception that Trump is envisioning more regulation on the sector.



"He's wondered aloud if there may be any way to go after Amazon with antitrust or competition law," according to a source who's spoken to the President. Whether or not that happens, there is absolutely no doubt that Trump has a point in his criticism of large tech companies for paying little to no taxes. This article is about the "great tech tax dodge" that Amazon, Facebook, Google, Apple and others have been practising for years. The colossal amount of money that has stayed out of the government's hands is a libertarian's dream, but it's also money that could have been put against the $20 trillion US debt, and that had to be covered by other companies and individuals who are paying their fair share, so that the US

government could pay its expenses. If this article makes you hopping mad, it should.

Trump vs Bezos

Briefly, let's recap what Trump says about Amazon, and separate some of the truth from fiction. The fight began in 2015 when Trump accused Bezos of using the *Washington Post,* the newspaper he owns, as a tax shelter for Amazon - even though the *Post* is owned by Bezos, not Amazon. But that hasn't stopped Trump from calling the *Washington Post* a "lobbying tool for Amazon" through anti-Trump Administration coverage that fits with politicians who are sympathetic to Amazon and are unlikely to go after its tax policy.

Amazon is a tech behemoth that is also a retail industry disruptor. It employs some 566,000 people worldwide, 341,400 more than it did at the end of 2016. Nearly two-thirds of US households have an Amazon Prime account. Online sales now account for 11.7% of total retail sales, according to Forbes, while major retailers like Sears and Macy's have closed hundreds of stores. Axios points out that Trump is a man of the 1950s, whose wealthy friends tell him Amazon is destroying their businesses - such as shopping malls and bricks and mortar stores:

"Trump told Axios last year he doesn't mind Facebook because it helps him reach his audience. He's an old-school businessman who sees the world in terms of tangible assets: real estate, physical mail delivery, Main Street, grocery stores. It reminds me of the story Jim [VandeHei] wrote a while back about Trump's fixation with 1950s life. Amazon takes direct aim at some of the core components of mid-century business."

More practically, Trump takes issue with Amazon using the US Postal Service to deliver its packages, claiming Amazon pays less than it should, as well as skirts paying state taxes. It's been shown that in fact Amazon pays the same low rates as other bulk shippers and collects sales tax in every state that charges it. But that’s not the real issue here. The real issue is how much tax Amazon and other tech companies have avoided paying. It is truly mind-boggling.

Trump carried his apparent hatred of Bezos and Amazon into the election campaign, using the company as a whipping boy to drum up support for tax reform. This also included lowering the corporate tax rate - before the tax bill was passed in December US corporate taxes were among the highest in the world - which fit into Trump’s vision of repatriating profits long held overseas by companies like Amazon and finally making them pay what they owe. Lower-taxed companies would be more profitable and therefore create more jobs in America, his thinking went, although that hasn’t actually happened.

Repatriation 2.0

The Republican tax overhaul lowered corporate taxes from 35 to 21%, and also changed the rules around the repatriation of corporate profits from the estimated $2.6 trillion in profits multinationals hold overseas. Bringing them back to America (“repatriation”) would mean getting taxed at 35% so most large companies deferred them, meaning they were kept offshore tax-free. Under the new law, these profits get mandatorily taxed, one time, at either 15.5% for cash holdings or 8% for illiquid investments. For example Apple under the new legislation is allowed to repatriate $252 billion in foreign cash, and will pay just $39.1 billion, or 15.5% in taxes, not 35%.

While Reuters points out that companies can manipulate their cash positions so they pay the lower rate, thus saving billions in taxes, the main point is that unless new laws are passed to avoid the tax dodges practised by the big tech companies and other large American firms, the IRS will continue to lose out “bigly”, to use a Trumpism.

And the IRS isn’t the only loser from this repatriation game. When repatriation was done by President George W. Bush back in 2004, the idea was the same (Ie. to spark an investment boom with all that cash plowed back into US companies) but it was regarded as an abject failure because up to 92% of the profits went into share buybacks - which as we have written about recently, benefit company executives, not individual shareholders. Why? Because repurchasing shares means money is not being spent on the company itself, such as buying new equipment or expanding, while also inflating earnings per share by reducing the share count. Buybacks also make it easier for executives to hit targets, and receive bonuses, by reducing the number of shares.

Tax evasion: by the numbers

You probably figured that most big companies hire large accounting firms to help them minimize their tax burden, and you'd be right. But the problem goes much deeper than this. Did you know that almost a quarter of large profitable US corporations in 2012 paid no tax at all? That's right. Zilch.

Those that did, paid well below the 35% corporate tax rate - on average, 14% between 2008 and 2012 according to the Government Accountability Office (GAO).

"There is something profoundly wrong in America when one out of five profitable corporations pay nothing in federal income taxes," Democratic presidential candidate Bernie Sanders, who asked for the numbers, said. *"We need real tax reform to ensure that the most profitable corporations in America pay their fair share in taxes. That means closing corporate tax loopholes to raise the revenue necessary to rebuild America and create millions of jobs."* Tax reform. Probably the only thing that Trump and Sanders agree on. Read on for Sanders' Top 10 Corporate Tax Avoiders.

The GAO explains the discrepancy as due to tax deductions for losses companies had in previous years that they carried forward. Or making profits offshore that they haven't yet brought back to the US. But there's something much more nefarious going on, as we shall soon see. But first, another few numbers.

The IRS estimates that tax evasion cost the federal government $458 billion a year between 2008 and 2010; the tax collectors think only $52 billion of that will ever be recovered.

Another report from Oxfam found that the country's 50 largest corporations have stashed over a trillion dollars offshore (the total is actually $2.6 trillion, as mentioned above), in over 1,500 subsidiaries in tax havens like the British Virgin Islands and the Caymans, costing the US government about $111 billion annually. In case you were wondering, this practice isn't illegal.

Just take Apple as an example. The Panama Papers investigation found the iPhone maker had accumulated $252 billion in offshore profits. Out of $41 billion Apple made in non-US profits, it paid taxes of just $2 billion, or 4.8%. Worldwide, multinationals withhold an estimated $500 billion from public coffers, The Guardian reported.

Sixty years ago corporations paid a third of federal government revenue; today, they pay about one-tenth. According to Americans for Tax Fairness, the average American family paid more taxes in one year than General Electric and dozens of companies paid in five.

How they do it

One of the most common is known as "tax inversion", explained in this video. Here the large company buys a smaller company in another country. The larger company then takes the smaller company's citizenship. This allows the larger company to take advantage of the foreign country's lower tax rate without actually moving operations. The larger company also doesn't pay the US tax rate on profits it earns overseas, until it repatriates them.

Three other tactics for avoiding taxes are:

- The US firm channels its profits through a subsidiary and then makes the subsidiary “disappear” by checking a box on an IRS form.

- The company sells the right to patents and licenses to an offshore subsidiary, in a tax haven, at a low price. The subsidiary then licenses back to the US parent at a steep price, allowing it to sell its products in the US. This makes it appear the company is making profits in the tax haven rather than the US. This is Amazon and Google’s preferred means of tax evasion (see below).
- Banks and firms with large financial units move US profits offshore using the “active financing exception” which makes it easier for multinationals to expand overseas. They avoid tax by creating “captive” foreign financing and insurance subsidiaries.

Big US tech companies have become experts in using some or all of these methods in different and complex variations.

Amazon

Jeff Bezos’ distaste for paying taxes goes as far back as 1995 when he was deciding where to set up his new e-commerce business. The story goes that his first choice was an Indian reservation near San Francisco where the taxes would have been considerably lower than anywhere else, but California vetoed the plan.

Bezos didn’t give up, and found the best way to be a tax evader was to get out of the US. Not literally, but by setting up his global headquarters in Luxembourg, of all places. There are reportedly 1,400 Amazon employees in the tiny landlocked European nation, compared to over 40,000 in Seattle.

The relationship with Luxembourg gets even juicier when one discovers that Jean-Claude Juncker, the former Luxembourg Prime Minister, and the current head of the European Commission (the executive branch of the EU) helped Amazon to locate there and met with several Amazon tax officials to set up the company’s European tax structure - allegations which Juncker of course denies.

Newsweek reports the tax structure was organized through “a labyrinth of subsidiaries designed to shift profits into Luxembourg” called Project Goldcrest:

“Project Goldcrest, which is still in place, uses a series of complex intercompany contracts to transfer intangible assets—vital software, trademarks and other intellectual property (IP)—to one of Amazon’s Luxembourg companies, Amazon Europe Holding Technologies. A separate subsidiary, Amazon EU Sarl, then pays AEHT huge sums every year in royalty fees, reducing the amount of taxable income within the company.

In return for controlling the European licensing rights, AEHT makes payments to one of Amazon’s U.S. companies. U.S. authorities believe these payments are too low, which is why the case has gone to court. Amazon has largely avoided federal taxation by managing its books to avoid reporting any meaningful profits over the past 20 years. In the last quarter of 2015, for example, Amazon paid just $73 million in taxes on $35.7 billion in revenues.” Newsweek

The European Union accused Luxembourg of giving illegal tax breaks to Amazon and ordered the country to recover $295 million in back taxes. The IRS then took Amazon to court, but lost in a landmark case in 2017 - meaning that Amazon avoided having to pay $1.5 billion in taxes.

The IRS said “Amazon overestimated the value of ‘intangible’ assets, such as software and trademarks, it had transferred to a Luxembourg unit, Amazon Europe Holding Technologies SCS” according to Fortune.

Amazon reportedly made $5.6 billion last year and paid nothing in federal taxes. The e-commerce giant, whose CEO’s net worth is $105 billion, is projecting a $789 million windfall from the Republicans’ tax bill. Meanwhile a January report found more than 10% of Amazon employees in Ohio rely on food stamps to buy groceries.

Amazon also pads its profits by allowing customers to avoid state sales taxes and share the savings according to Business Insider.

Other countries in which Amazon does business have also lost out on billions in tax revenue. The Mirror reported in 2016 that five of the world's biggest tech companies avoided paying over a billion British pounds in taxes. Amazon, Apple, eBay, Facebook and Google reported revenues of just £2.6 million but the UK sales of the five firms were closer to £18 billlion - a discrepancy that meant the five paid just £45 million in corporation tax - a rate of 0.25%.

A February Esquire article on Silicon Valley's "tax-avoiding, job-killing, soul-sucking machine" notes "The Big Four" tech giants - Amazon, Apple, Facebook and Google - have a combined market cap of $2.8 trillion (the same GDP as France) and represent a quarter of the S&P 500 Top 50. With a market value of $591 billion Amazon is worth more than Walmart, Costco, T. J. Maxx, Target, Ross, Best Buy, Ulta, Kohl's, Nordstrom, Macy's, Bed Bath & Beyond, Saks/Lord & Taylor, Dillard's, JCPenney, and Sears combined, writes author Scott Galloway. Facebook and Google (now Alphabet) are together worth $1.3 trillion.

Between 2007 and 2015, Galloway calculates Amazon paid 13% of its profits in taxes, Apple 17%, Google 16%, and Facebook 4%. Recall the corporate tax rate until 2018 was 35% and the average tax rate for the S&P 500 was 27%.

Google / Alphabet

What do Ireland, Holland and Bermuda have in common? Nothing, apart from the fact that the three countries are linked into a complicated scheme for California-based Google to take advantage of loopholes that help it avoid paying US taxes. In 2003, the year before it went public, the world's most well-known search engine started moving the parts in place. It first transferred all its intellectual property to an entity it set up called Google Ireland Holdings. Why Ireland? Because the home of leprechauns, shamrocks, some pretty good whiskey and U2 has a lower tax rate than the US and allows Google Ireland Holdings to be incorporated there but "managed" in Bermuda, which has no corporate tax. Another Irish subsidiary, Google Ireland Limited, was created and granted a license to use the technology owned by Google Ireland Holdings. Google Ireland

Limited is the company that licenses Google's technology to other countries, for which it is paid royalties. And in the final step, Google Ireland Limited moves its profits to Bermuda.

A report in The New York Times states that in 2015 $15.5 billion in profits went to Google Ireland Holdings in Bermuda, despite having no employees there. That equates to each inhabitant of the island making the company $240,000. The tax shell game saved Alphabet, Google's parent company, $3.6 billion in taxes.

NYT also drops this gem: nearly two-third of all profits made by US multinationals are reported in six countries where the tax is either zero or very low: the Netherlands, Bermuda, Luxembourg, Ireland, Singapore and Switzerland.

With me so far? Now it gets complicated. Adding another layer of tax avoidance known as the "Double Irish", which sounds a lot like a hardball, a pair of Irish companies are formed to turn intellectual property payments into tax-deductible royalty payments. Google then forms a subsidiary in Ireland and signs the European intellectual property rights to the new company. The subsidiary in return gets to market the products in Europe - meaning all the European income is taxable in Ireland rather than the US. However no tax is paid in Ireland at this point, because the Irish subsidiary moves its headquarters to Bermuda. A second Irish subsidiary is disregarded for US tax purposes by ticking a box on the IRS form (see bullet point one above). The first Irish company then licenses products to the second Irish company, which receives royalties. The result is a 12.5% tax rate in Ireland versus 35% in the US (now 21%). The tax can be reduced further because the royalties going to the Bermuda company are tax-deductible. According to SEC filings, Alphabet's tax rate outside the US was 6.4% in 2015.

With a "Dutch Sandwich", the arrangement starts with a Double Irish, and adds a third subsidiary in the Netherlands, which according to Forbes, is Google's model. Facebook and Google are thought to use similar tax structures, with Facebook reportedly flipping over $700 million to the Cayman Islands as part of a "Double Irish".

Facebook

Facebook has been in the news a lot lately over privacy concerns relating to the hijacking of personal data by a political firm, but it is less known that the world's largest social media platform is also one of the most successful tax dodgers. Think about that next time you "like" something. Along with offshore tax shelters, Facebook avoids paying US tax through a loophole whereby highly paid employees receive stock options rather than a salary. When companies do this, they get big tax deductions. For example, an executive is given the option to buy a million shares at 5 cents apiece, and later cashes them when they're at $20 a share. The difference can be deducted by the company as a tax break, as explained by Mother Jones. The companies can "store" these tax breaks, allowing them to avoid paying taxes for years. The chart below shows how much tax 12 companies saved through this loophole:

Mother Jones bashes a counter-argument that the executive who cashes in his options has to pay income tax at a higher (individual) rate versus the corporate rate, because under the loophole the company is allowed to effectively write off the employee's salary:

Future Stock Tax Benefits of 12 Tech Companies

Company	Unused Stock Deductions ($Millions)	Likely No-Tax Years
3D Systems	174	7.1
Cirrus Logic	121	1.0
Facebook	6,200	4.8
LinkedIn	571	10.6
NetApp	484	2.4
Priceline	900	7.5
Rackspace Hosting	734	11.3
Salesforce.com	903	NA
Twitter	107	NA
Verisign	233	1.8
WebMD	826	NA
Zynga	178	NA
Total	**$ 11,432**	

Source: Companies' 10-K annual reports, 2012

"If Facebook buys Zuckerberg a lottery ticket for a buck, and then he wins a million dollars, should the company be able the write off that million? That's absurd, but that gives you a sense of what's going on here," the publication quotes Matt Gardner, executive director of the Institute on Taxation and Economic Policy.

Facebook is also playing tax games in the UK with its British arm. The Guardian notes in 2014 the company's UK employees received over £210,000 in pay and bonuses, while Facebook UK paid just £4,327 in corporation tax. Facebook also inexplicably reported a loss that same year of £28.5m, enabling it to pay under £5,000 in taxes, despite shelling out over £35m to its 362 staff in a share bonus scheme.

Apple

Who doesn't love Apple, with its user-friendly operating system, easy compatibility between devices, and shiny lightweight phones? You, once you learn about how America's favorite handheld company manages to dodge billions in corporate taxes.

Earlier I mentioned that Apple under the new tax code will pay $39.1 billion in taxes at the new 15.5% rate for repatriated foreign cash totalling $252 billion. At the previous 35% rate it would've paid $78.6 billion in taxes - enabling Apple to avoid nearly $40 billion in taxes. Hardly something worth cheering about. Fortune also notes that between them, Microsoft, Facebook, Apple and Alphabet spent $16.3 million in the third quarter lobbying the federal government for a one-time, 15.5% "tax holiday" for their repatriated overseas profits. Even more galling is that Apple announced that its planning to create 20,000 new jobs as a result of the tax changes. But as Fortune columnist Josh Hoxie, director of the Project on Opportunity and Taxation, opines, the last time firms were allowed to repatriate cash held overseas, in 2004, the top 15 repatriating firms actually cut their US workforce by 21,000 jobs.

Apple is also no dummy when it comes to offshore tax loopholes. According to the Paradise Papers, in 2014 Apple learned that Irish tax authorities were going to close loopholes it had used to funnel overseas profits sheltered from US tax. The tech giant therefore simply moved its tax shelter to Jersey, the English Channel island, which does not tax corporate income. US Senators were apparently incensed by the move, including Republican Senator John McCain, who said:

“Apple claims to be the largest US corporate taxpayer, but by sheer size and scale it is also among America’s largest tax avoiders … [It] should not be shifting its profits overseas to avoid the payment of US tax, purposefully depriving the American people of revenue.”

Well said, John.

Conclusion

US technology companies have rewarded shareholders and been a major force behind the stock market bull over the past few years, so it’s easy to look the other way if you’re one of the ones sharing their profits. But the success of tech comes at a price, and it’s a price being paid by US taxpayers who are owed a hell of a lot more than they’re getting from these corporate tax avoiders – some who it should also be noted, are making huge profits off of the backs of their users, who either willingly or without their knowledge, are surrendering their private information to advertisers who are free to pester them with pop-up ads and videos that follow people around like a bad smell.

It’s time to get serious about corporate tax evasion. The simplest solution would be to tax multinationals on where they actually do businesses, not where they artificially, and opaquely, shift their profits. Like to Bermuda, the Cayman Islands or Jersey. But nothing will happen unless officials at the highest level of the US government force them to change their tax, or more appropriately, anti-tax policies. Enter President Trump. Love him or hate him, Trump may be the guy to take the tech giants to the wall. And make them finally pay what they owe. Are you pissed off, have you got the great tech tax dodge on your radar screen?

If not, perhaps you should.

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