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Amazon's Tax Scheme in Luxembourg

By Zachary Nguyen, J.D. Candidate 2017 | February 10, 2015

Amazon, a Seattle-based company, negotiated and struck a deal with Luxembourg in 2003 that effectively granted the company exemption from all tax payments in the entirety of Europe. The deal, still in force, limits Amazon's tax liabilities only to Luxembourg.

As a multinational corporation, Amazon strategically sells its goods from Luxembourg to other European countries. The company's warehouses and logistics chains across Europe fall under standard tax treaties that do not treat them as a "permanent establishment" in the countries in which they are stationed. To be subject to corporate tax in a European country, a company needs to have permanent establishment within its borders. Since Amazon does not have permanent establishment in any European country, taxes due on profits from European sales pile up only in Luxembourg and are "taxed as [Luxembourg] decides they should be."

Amazon's deal with Luxembourg, in and of itself, poses no legal issues. However, what is concerning is Amazon's two-unit arrangement within Luxembourg. The company has one unit responsible for all of the selling and buying of goods and employment of people. The second unit collects brand royalties, technology, and the like from the first unit. The second unit, however, is tax-exempt in Luxembourg since royalty collection is not taxed. How much tax is paid to Luxembourg, then, depends on royalty rates negotiated between the two parties.

This tax relationship is not tax evasion since the local government agrees that Amazon has closely followed the law. This is certainly tax avoidance. However, this may be state aid or state subsidy, something not allowed under European laws.

Luxembourg's "unorthodox tax deal" with Amazon attracted European Commission investigators, who believe that the deal breached European laws. In a 23-page letter outlining initial conclusions from its investigation, the Commission alleged that Amazon's deal 1) amounts to an illicit state subsidy and 2) deviates from international standards that do not reflect business risks assumed by a Luxembourg headquarters corporation. The cap on taxable income in Luxembourg is less than one percent, or about €75 million in 2013 on operating sales of €13.6 billion.

Luxembourg has responded that it was "confident that the allegations of state aid in [the European Commission's investigation] are unsubstantiated." Amazon also responded that it has received "no special tax treatment" and are "subject to the same tax laws as other companies operating [in Luxembourg]." Luxembourg continues to cooperate fully with the Commission.

Even if the allegations against Amazon eventually result in no fines, the Commission's investigation signals two important consequences. First, this may be a sign that the tax investigation could spread wider than Luxembourg. Regulators are already sifting through tax deals in other European countries, including Belgium, Ireland, the Netherlands, and the U.K.

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Second, the Commission will continue to pursue other high-profile tax investigations: Ireland's arrangement with Apple, the Netherland's approval of Starbucks' tax base, and Luxembourg's deal with Fiat.

Given that the European Commission is empowered to recoup illegal "aid stretching" back up to ten years, Amazon faces uncertainty in corporate tax liabilities if the investigation successfully continues moving forward.