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UNIVERSITY OF CALIFORNIA
Berkeley Center for
Law and Business

Berkeley Center for Law and Business
University of California, Berkeley
School of Law
Boalt Hall #7200
Berkeley, CA 94720-7220

Amazon: Two Years Tax-Free

By David Feirstein, J.D. Candidate 2021 | March 19, 2019

Amazon raked in $11.2 billion in profit last year, about double its 2017 profits of $5.6 billion. However, instead of paying a 21% income tax rate on its U.S. earnings, Amazon reported a $129 million federal tax rebate for 2018. This represents the second year in a row that Amazon paid zero federal income taxes despite its staggering profits.

In 2017, Amazon benefitted from a huge, one-time tax write-off from the December enactment of the 2017 Tax Act. Because of the permanent reduction in the corporate tax rate from 35% to 21%, it remeasured federal net deferred tax liabilities for a tax benefit of $789 million. Deferred tax liabilities are recorded when figures for accounting purposes differ from figures for tax purposes, such as when depreciation on equipment for accounting purposes is less than depreciation using accelerated depreciation for tax purposes. This difference eventually reverses out, which is why it is recognized as a liability. When the tax rate decreases, that eventual payment on the deferred tax will be lower than originally anticipated, which manifests as a reduction in income tax expense in the period of enactment.

Amazon attributed its low-income taxes in 2017 to this one-time favorable effect of the 2017 Tax Act as well as tax benefits from its stock compensation. Yet, in 2018, Amazon again paid zero income taxes. In note 9 of its financial statements, it vaguely represents $419 million of "tax credits" and $1.1 billion of benefits from stock compensation.

Paying stock compensation occurs quite often as a means of reducing tax liability. Indeed, according to Netflix's 2018 financials, it paid an effective 1% tax rate with stock compensation being its largest write-off. Stock compensation serves as an attractive means of compensation because, minus a slight timing difference, it allows companies to benefit from the tax deduction of a normal compensation expense while also not limiting cash flow.

The other $419 million of Amazon's tax credits is likely due to accelerated depreciation of its equipment and property. The 2017 Tax Act enhanced the option to claim bonus depreciation from 50% to 100% for qualified property acquired and placed in service in 2018, and Amazon purchased $13.4 billion worth of property and equipment in 2018. Not surprisingly, this increase in property and equipment corresponded with an increase in its deferred tax liabilities from depreciation and amortization by about $1 billion in 2018.

While Uncle Sam clearly missed its share of Amazon's 2018 profits, 2018 does not necessarily mark the end of the story. The 100% bonus depreciation creates a deferred tax liability that eventually reverses out. While Amazon and other companies take full advantage of the Act and invest today, Uncle Sam may eventually gain back the losses of tax revenue through a larger economy, fueled by today's capital investments. Of course, this assumes companies will return their profits from overseas.