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Why Amazon Pays No Corporate Taxes

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Amazon E-commerce pick up store. GETTY

Amazon's recent decision to pull HQ2 out of New York City has reignited an older debate about why the company pays "no taxes." One graphic, for example, produced by data journalist Mona Chalabi and subsequently reshared by House member Alexandria Ocasio-Cortez among many others, shows two superimposed graphs comparing Amazon's quickly growing profit next to its negligible taxes over the last nine years.

The comparison is striking. And also misleading. As one of today's most influential economists, Tyler Cowen, wrote on his site *Marginal Revolution,* "When it comes to the discussion surrounding Amazon and taxes, I can only sigh...."

What Is The Purpose Of A Tax?

First, a quick look at Amazon's financial statements shows it does pay taxes. In 2017, Amazon paid close to $1 billion in income tax. In 2018, the amount jumped to $1.18 billion, accounting for local, state, and international taxes.

> "Amazon pays plenty in terms of payroll taxes and also state and local taxes. Nor should you forget the taxes paid by Amazon's employees on their wages. Not only is that direct revenue to various levels of government, but the incidence of those taxes falls somewhat on Amazon, which now must pay higher wages to offset the tax burden faced by their employees," Cowen adds.

It is true that in the last two years, Amazon did not pay federal taxes. (It's odd to think I paid more federal tax last year than Amazon did.) But before yelling partiality, it is worth understanding why. A more thorough examination of the underlying economics demonstrates that only looking at Amazon's profits versus corporate taxes is too simplistic of a model.

Instead, a good place to start is understanding economic incentives. Incentives, in laymen's terms, sound like free money. Incentives, to an economist, operate as a lever to generate a better result which offset the cost. Taxes are one such lever.

But taxes are too often interpreted only by their first-order effect of generating revenue, rather than the second-order effect of stimulating economic activity.

If you look at the Internal Revenue Code, as one CPA cites, less than 1% of it is dedicated to revenue generation. The majority, in fact, is on tax deductions. "There are only about 30 pages in the Code that actually raise revenue...[T]here are about 6,000 pages that tell you how to reduce taxes through tax deductions, tax credits and other incentives."

Tax deductions can be incorrectly categorized as "crony capitalism." But tax deductions, tax credits, and other incentives act as an important driver for organizations to then stimulate economic activity, job creation, and innovation.

Amazon's Tax Breaks And The Underlying Incentives

There are three main drivers of Amazon's tax breaks:

- **Investment in Research & Development**. Amazon invests heavily in research and development and therefore benefits from the tax credit. In 2017, as Recode stated, Amazon topped the list of U.S. companies in R&D spend, at $22.6 billion. The next closest was Alphabet at $16.6 billion. Many of Amazon's innovations have been birthed from this investment.

- **Investment in Property, Plant, and Equipment**. Amazon's investment in property, plant, and equipment also makes it eligible for tax credits. Cities can benefit from Amazon's investment in real estate and job creation (benefits New York City could have enjoyed). Amazon's PPE expenditure has steadily increased over the last five years, netting to approximately $60 billion as of the end of last year.
- **Employee Stock Compensation**. A move away from cash compensation to stock-based compensation for employees is the third driver of its tax breaks. Tax deductions increase as the stock increases. While this can certainly create adverse incentives, it is important to assess the benefits it creates relative to the cost. While such a tax policy can introduce misaligned management incentives, it also generates incentives for management to drive the best possible return for investors.

Amazon largely pays no *corporate* tax precisely because it reinvests those profits into its operations. Under a scenario where Amazon had no corporate tax breaks, it would disincentive the company from reinvesting and thus creating greater opportunity for the businesses and cities in which it operates.

Raising a pitchfork to fight Amazon's corporate tax breaks is fine if the argument is rooted in strong economic reasoning. The risk is that too often the data is pulled out of context, and inaccurate storylines circling that data gain momentum and undeservedly accelerate.

The building impetus to tear down existing economic structures without a strong grounding in why the structures even exist could land us in a worse position. The question to address is not why Amazon pays no taxes, but under what tax structure could we be better off?