

## NEW RISK ALERT: (ADBE)

# Adobe Avoids Taxes With \$1.3 Billion Game of Irish Chess

New language in latest 10-K reveals Adobe paid no tax in 2020 thanks to a \$1.35 billion tax benefit.

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*This alert compares the language used in the company's latest filing with the period before. Research suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.*

## Adobe's Effective Tax Rate is -26%

Adobe, a SaaS platform offering commerce, marketing, and digital experience solutions, reduced its tax rate 34% in 2020 by shifting some of its intellectual property (IP) to Ireland, where the corporate tax rate is 12.5%. In its 2020 [10-K](#), Adobe suggests the primary reason for the transfer was not to avoid paying taxes:

*"During fiscal 2020, we completed intra-entity transfers of certain IP rights to our Irish subsidiary in order to better align the ownership of these rights with how our business operates."*

The IP transfers occurred in two phases, with the second—which resulted in a \$1.13 billion tax benefit—occurring just as Adobe closed its fiscal year books in November. The result was an effective tax rate of -26%. The tax benefit would have been larger had Adobe not taken a [valuation allowance](#), which is recognized when it's likely that not all of a deferred tax asset will be realized:

*"The transfers did not result in taxable gains; however, our Irish subsidiary recognized deferred tax assets for the book and tax basis difference of the transferred IP rights. As a result of these transactions, we recorded deferred tax assets, net of valuation allowance, and related tax benefits of **\$224 million and \$1.13 billion**, based on the fair value of the IP rights transferred in April and November 2020, respectively."*

## Adobe Saves Shareholders an Estimated \$514 Million

Adobe's revenue topped \$12.8 billion in 2020, an increase of 15% from the prior year. In the five years prior, Adobe's tax bill was, on average, 4% of revenue. It means the IP transfers saved Adobe an estimated \$514 million in taxes in 2020. The following month, Adobe announced a \$15 billion share repurchase program. The announcement— combined with the tax savings— is undeniably shareholder friendly.

However, the moves are not without risk. Besides political risk— President Biden asked CEOs to halt buybacks in 2020— there's also risk that the IP tax benefits may be reversed. Though the amortization related to the transferred IP rights will be tax deductible for the life of the IP, Adobe warns the move will have future consequences:

*"In years beyond fiscal 2020, the change in the geographic mix of international income resulting from these transfers is anticipated to **adversely affect our effective income tax rates and cash flows**. However, the adverse impact to effective rates for cash paid for income taxes will be partially offset by future deductions on the transferred IP rights."*

Likewise, the fair value calculation used in calculating the tax benefit is based on a variety of assumptions; future revenue growth, operating margins and discount rates. If these assumptions are wrong, or tax authorities don't like what they see, Adobe suggests the tax benefit could be reduced or reversed:

*"Unanticipated events and circumstances may occur that could affect either the accuracy or validity of such assumptions, estimates or actual results. The sustainability of our future tax benefits is dependent upon the acceptance of the valuation estimates and assumptions by the taxing authorities."*