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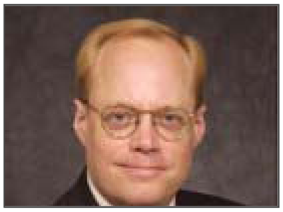

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Caterpillar's Terrible, Horrible, No Good, Very Bad Day

Caterpillar Inc. is about as American as you can get, except that these days it's not, having been partially shuffled off to Switzerland. But it still must deal with the IRS, and the IRS isn't happy with the heavy equipment maker. In fact, the IRS is trying to add $1 billion in taxes and penalties to the company's 2007-2009 year.

Many of the proposed adjustments evidently relate to the Swiss entity as well as to foreign tax credits. Caterpillar has said it is fighting the IRS. But Caterpillar faces other legal process too, including a grand jury subpoena requesting information about the movement of cash among U.S. and non-U.S. units. The company was in the Senate hot seat in 2014. A report by the Senate Permanent Subcommittee on Investigation said the company avoided $2.4 billion in U.S. taxes over 13 years by shifting profits to Switzerland.

Senator Carl Levin (D-MI) grilled Caterpillar execs and PricewaterhouseCoopers accountants over the company's offshore move of 85% of its parts sales. Most of Caterpillar's parts business remained in the U.S., including employees and execs. Only 65 of over 8,000 parts employees are in Switzerland, claimed Sen. Levin, noting that "nothing changed in the operations."

Sen. Levin called it a sweetheart “tax deal pure and simple to shift profits between related parties.” But Caterpillar V.P. Julie Lagacy defended the deal saying it was legit. This echoes others who have appeared before Levin, including Apple CEO Tim Cook. The biggest surprise of the hearing was the Republican pushback defending Caterpillar and noting that the tax code was to blame. In fact, Sen. Rand Paul, R-Ky., went so far as to suggest that Caterpillar deserved an award, not an inquisition.

Sen. Paul said Caterpillar and its accountants have an obligation to shareholders to minimize their taxes. The hearing was perhaps most uncomfortable for the accountants asked about emails that seemed to poke fun at the fact that they might be retired by the time of an audit. Nevertheless, there was nothing definitive in the hearing, other than that taxes are terribly complex, and that multinational companies can and do try to move things around to save. Apple’s Tim Cook testified to the same effect, though without the Republican support Caterpillar mustered.

Individuals may scratch their heads at how U.S. multinational companies plop profits offshore. After all, the Swiss banking scandals since 2008 make it clear that for individuals, everything is income worldwide. Multinational companies are different, and even “stateless” income is possible. Yet Sen. Levin and others would like to see more harmony in the tax code and a tightening of this “stateless” income.

Tax havens like Ireland are favored by global giants like Apple, Google, HP, Facebook and Twitter. In 2013, the Senate Permanent Subcommittee on Investigations said Apple avoided $9 billion in U.S. taxes in 2012 alone via offshore units with no tax home. Apple's CEO Tim Cook testified it was nothing illegal. Calling it the "holy grail of tax avoidance," Sen. Levin claimed that Apple saved billions by claiming companies registered in Ireland are not tax resident in any country.

Even Facebook flipped more than $700 million to the Cayman Islands as part of a "Double Irish" tax reduction strategy. Google used the Double Irish and the Dutch Sandwich, saving billions in U.S. taxes. Global companies like Apple, Starbucks and Hewlett-Packard put income in foreign pockets in ways the IRS doesn't like. And the IRS isn't alone in its criticism. The G20 countries and the Organization for Economic Co-operation and Development (OECD) call it tax manipulation.

The OECD, which advises the G20 on tax and economic policy, says existing national tax enforcement regimes just don't work. The G20 is made up of 19 leading world economies plus the European Union. It too has voiced support for a fundamental reassessment of the rules on taxing multinationals. Some companies say they would like nothing better than to repatriate profits to the U.S., if only it wouldn't be taxed.

Staggeringly, U.S. companies are said to have more than $1.5 trillion offshore. Most claim that they *have to* keep the money there to avoid the taxes they would face by bringing funds back to the U.S. Sadly, though, even if Congress were able to agree on legislation, this will take considerably time. Meanwhile, Caterpillar is likely to have a long tax battle ahead of it.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.