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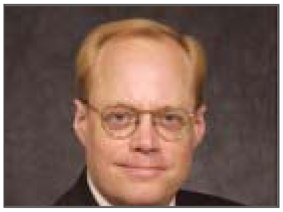

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Caterpillar Bulldozes Tax Code Like Apple, Google & Facebook, Senators Allege

Caterpillar sidestepped $2.4 billion in U.S. taxes over 13 years by shifting profits to Switzerland, claims a report by the Senate Permanent Subcommittee on Investigation. Senator Carl Levin (D-MI) grilled execs and PricewaterhouseCoopers accountants over Caterpillar's offshore move of 85% of its parts sales. Most of Caterpillar's parts business remains in the U.S., including employees and execs, the report says. Only 65 of over 8,000 parts employees are in Switzerland, claims 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.

Caterpillar D10N bulldozer (Photo credit: Wikipedia)

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 manage to 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 May 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. No, these aren’t food products.

The Double Irish involves forming a pair of Irish companies to transform payments on intellectual property into tax-deductible royalty payments. Google and Microsoft cut their overseas tax rates to single digits with Dublin-registered subsidiaries designated as tax resident in Bermuda. Google and Apple have Irish-registered and tax resident subsidiaries that make sales to customers.

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 OECD plan claims that companies like Apple and Google avoid billions in taxes. 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. And in a sense, the Republicans defending Caterpillar are right that the U.S. tax code seems to encourage all this behavior.

Some companies say they would like nothing better than repatriating profits to the U.S. if they could only do it in a way that won’t be taxed. The amounts at stake are staggering. U.S. companies are said to have more than ***$1.5 trillion*** offshore. Most claim that they ***must*** keep the money there to avoid the taxes they would face by bringing it back to the U.S.

“We must address the persistent issue of ‘stateless income,’ which undermines confidence in our tax system at all levels,” U.S. Treasury Secretary Jack Lew has said. Sadly, retooling the law, even if there were agreement in Congress, will take time. Meanwhile, despite the hearings and theatrics, little seems likely to change.

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.