Caterpillar Uses Swiss Subsidiary to Avoid Billions in Taxes

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Caterpillar – one of the world's largest maker of construction and mining equipment – used a subsidiary in Switzerland to avoid paying $2.4 billion in taxes over a period of 13 years, according to a new U.S. Senate report titled 'Caterpillar's Offshore Tax Strategy.'

In 2013, Illinois-based Caterpillar reported that 62.2 percent of its pretax income of $55.7 billion was earned outside the U.S., but the new investigation raises the question of whether some of that foreign income should have been reported and taxed at home.

The report was issued as part of a Senate Subcommittee investigation to highlight different methods of tax avoidance used various U.S. companies like Apple, Hewlett-Packard and Microsoft among others. A 2014 report by Citizens for Tax Justice and the Institute on Taxation and Economic Policy revealed that many corporations actually pay far less than the legal rate of 35 percent of profits – in fact many pay nothing at all, because of the many tax loopholes and special breaks that they exploit.

"Caterpillar Inc. is a member of the corporate profit shifting club that has transferred billions of dollars offshore to avoid paying U.S. taxes," said U.S. Senator Carl Levin, the chairman of the subcommittee that produced the report.

Until the year 2000, 85 percent of Caterpillar sales were conducted from the company headquarters in Illinois with the rest made by foreign subsidiaries. With the help of PricewaterhouseCoopers (PwC), an international tax consulting firm, Caterpillar set up a subsidiary named CSARL in Geneva in 1999 to handle sales for replacement parts, allowing Caterpillar to reduce its U.S. tax bill by an estimated $300 million each year. However, out of 8,300 employees "employed" by CSARL, 4,900 were in the U.S. and only 65 were physically employed in Switzerland.

All told, Caterpillar paid PwC $55 million for helping it transfer $8 billion of profits to CSARL between 1999 and 2012, according to the Senate report, following the reorganization in 1998.

In January 2007, two company tax specialists sent a series of internal emails to senior management to warn them that the Swiss activity "lacked economic substance and had no business purpose other than tax avoidance."

For example Daniel Schlicksup, former global tax strategy manager, sent an email in January 2007 to the company's ethics officers noting that approximately $1 billion in profits from a U.S. division had been incorrectly attributed to CSARL. A year later, Schlicksup sent another email to Robin Beran, the head of the Caterpillar's tax department, requesting that the matter be discussed with the board.

"With all due respect, the business substance issue related to the CSARL Parts Distribution is the pink elephant issue worth a Billion dollars on the balance sheet. . . I have been asking for more than a year if we have memos with proper facts and analysis," wrote Schlicksup.

Instead of responding to his requests, company management transferred Schlicksup to a different division. On June 12, 2009, Schlicksup filed a whistleblower lawsuit against Caterpillar alleging that the company had improperly attributed at least $5.6 billion of profits from the sales of spare parts to a unit in Geneva. The company settled the lawsuit out of court in 2012.

The company is well known for playing hardball to reduce its tax exposure. For example, in March 2011, a leaked letter from Doug Oberhelman, the Caterpillar CEO, to the state of Illinois revealed that the company was threatening to close its operations in the state unless the company was awarded tax breaks, noting that the company finance department had calculated that helped the company reduce its effective tax rate to the "lowest in the Dow 30" in 2012.

Julie Lagacy, a vice president in the Caterpillar's finance services division, defended the company at a Senate hearing, chaired by Levin, earlier this month. "Our average effective tax rate is 29 percent, " she said. "That's one of the highest for a multinational manufacturing company – 3 percentage points higher than the average effective rate for U.S. corporations.

Beran, who also testified at the hearing, complained that the company was being unfairly targeted by the federal government. "We are under continuous examination," he said. "The Internal Revenue Service (IRS) literally sits right outside my office."

Not all the legislators were upset with Caterpillar. Rand Paul, a Republican senator from Kentucky, defended Caterpillar. "I think rather than having an inquisition we should probably bring Caterpillar here and give them an award," he said, "They've been in business for over 100 years. It's not easy to stay in business."

Companies like Caterpillar constitute a powerful lobby against changes to the tax code, donating generously to politicians on all sides of the political spectrum. So it is not surprising that a proposed reform bill – the Stop Tax Haven Abuse Act – sponsored by Levin – has stalled in the Senate.

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